

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2011**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-31588

COMMUNICATIONS SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

MINNESOTA

(State or other jurisdiction of
incorporation or organization)

41-0957999

(Federal Employer
Identification No.)

10900 Red Circle Drive, Minnetonka, MN

(Address of principal executive offices)

55343

(Zip Code)

(952) 996-1674

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES
NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined by Rule 12b-2 of the Exchange Act).

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Name of Exchange On Which Registered	Outstanding at November 1, 2011
Common Stock, par value \$.05 per share	NASDAQ	8,465,840

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COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30 2011	December 31 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 20,084,605	\$ 16,787,558
Investments	18,780,107	21,698,905
Trade accounts receivable, less allowance for doubtful accounts of \$283,000 and \$500,000, respectively	21,403,472	17,544,136
Inventories	26,012,133	24,498,935
Prepaid income taxes	570,567	296,586
Other current assets	954,437	908,102
Deferred income taxes	3,616,487	4,469,941
TOTAL CURRENT ASSETS	91,421,808	86,204,163
PROPERTY, PLANT AND EQUIPMENT, net	13,424,106	13,214,067
OTHER ASSETS:		
Investments	4,458,186	4,588,267
Goodwill	5,320,707	4,560,217
Prepaid pensions	326,178	349,575
Other assets	1,762,620	153,938
TOTAL OTHER ASSETS	11,867,691	9,651,997
TOTAL ASSETS	\$ 116,713,605	\$ 109,070,227
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 420,131	\$ 399,209
Accounts payable	4,070,190	5,385,558
Accrued compensation and benefits	5,043,674	3,951,401
Other accrued liabilities	3,376,121	1,669,776
Dividends payable	1,288,875	1,263,434
TOTAL CURRENT LIABILITIES	14,198,991	12,669,378
LONG TERM LIABILITIES:		
Long-term compensation plans	257,572	1,738,105
Income taxes payable	683,081	678,395
Deferred income taxes	1,113,730	585,317
Long term debt - mortgage payable	1,684,574	2,002,339
TOTAL LONG-TERM LIABILITIES	3,738,957	5,004,156
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, par value \$1.00 per share; 3,000,000 shares authorized; none issued		
Common stock, par value \$.05 per share; 30,000,000 shares authorized; 8,461,032 and 8,422,890 shares issued and outstanding, respectively	423,051	421,144
Additional paid-in capital	35,419,658	34,491,370
Retained earnings	63,320,527	56,769,816
Accumulated other comprehensive loss, net of tax	(387,579)	(285,637)
TOTAL STOCKHOLDERS' EQUITY	98,775,657	91,396,693
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 116,713,605	\$ 109,070,227

The accompanying notes are an integral part of the condensed consolidated financial statements.

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF
INCOME AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	<u>Three Months Ended September 30</u>		<u>Nine Months Ended September 30</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Sales from operations	\$ 41,984,570	\$ 33,323,793	\$ 118,437,057	\$ 89,864,628
Costs and expenses:				
Cost of sales	25,429,300	18,013,809	70,097,713	50,755,575
Selling, general and administrative expenses	10,071,408	9,005,699	29,189,378	26,492,580
Goodwill impairment	0	0	1,271,986	0
Total costs and expenses	<u>35,500,708</u>	<u>27,019,508</u>	<u>100,559,077</u>	<u>77,248,155</u>
Operating income	6,483,862	6,304,285	17,877,980	12,616,473
Other income and (expenses):				
Investment and other income	138,990	92,363	275,852	177,788
Gain (loss) on sale of assets	5,310	9,763	(4,674)	1,143
Interest and other expense	(53,256)	(51,854)	(149,107)	(160,305)
Other income, net	91,044	50,272	122,071	18,626
Income before income taxes	6,574,906	6,354,557	18,000,051	12,635,099
Income tax expense	<u>2,845,269</u>	<u>2,355,163</u>	<u>7,627,910</u>	<u>4,889,452</u>
Net income	3,729,637	3,999,394	10,372,141	7,745,647
Other comprehensive income (loss), net of tax:				
Additional minimum pension liability adjustments	(8,534)	(17,009)	(26,952)	(30,590)
Unrealized gains (losses) on available-for-sale securities	(5,094)	11,779	(30,510)	13,259
Foreign currency translation adjustment	<u>(112,581)</u>	<u>149,786</u>	<u>(44,480)</u>	<u>(60,059)</u>
Total other comprehensive income (loss), net of tax	(126,209)	144,556	(101,942)	(77,390)
Comprehensive net income	<u>\$ 3,603,428</u>	<u>\$ 4,143,950</u>	<u>\$ 10,270,199</u>	<u>\$ 7,668,257</u>
Basic net income per share:	\$ 0.44	\$ 0.48	\$ 1.23	\$ 0.92
Diluted net income per share:	\$ 0.44	\$ 0.48	\$ 1.22	\$ 0.92
Average Basic Shares Outstanding	8,460,625	8,398,496	8,442,812	8,376,542
Average Dilutive Shares Outstanding	8,530,187	8,414,865	8,500,022	8,401,212
Dividends per share	\$ 0.15	\$ 0.15	\$ 0.45	\$ 0.44

The accompanying notes are an integral part of the condensed consolidated financial statements.

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
BALANCE AT DECEMBER 31, 2010	8,422,890	\$ 421,144	\$ 34,491,370	\$ 56,769,816	\$ (285,637)	\$ 91,396,693
Net income				10,372,141		10,372,141
Issuance of common stock under Employee Stock Purchase Plan	6,649	332	104,377			104,709
Issuance of common stock to Employee Stock Ownership Plan	22,493	1,125	314,902			316,027
Issuance of common stock under Non-Employee Stock Option Plan	9,000	450	72,450			72,900
Tax benefit from non-qualified stock options			23,227			23,227
Share based compensation			413,332			413,332
Shareholder dividends				(3,821,430)		(3,821,430)
Other comprehensive income					(101,942)	(101,942)
BALANCE AT SEPTEMBER 30, 2011	8,461,032	\$ 423,051	\$ 35,419,658	\$ 63,320,527	\$ (387,579)	\$ 98,775,657

The accompanying notes are an integral part of the condensed consolidated financial statements.

COMMUNICATIONS SYSTEMS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 10,372,141	\$ 7,745,647
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,571,423	1,418,065
Share-based compensation	413,332	39,093
Deferred income taxes	973,817	(474,900)
Goodwill impairment	1,271,986	—
Gain (loss) on sale of assets	4,674	(1,143)
Excess tax benefit from stock based payments	(23,227)	—
Changes in assets and liabilities:		
Trade receivables	(3,664,939)	(5,315,719)
Inventories	(609,224)	302,888
Prepaid income taxes	(273,981)	337,274
Other assets	21,595	(508,666)
Accounts payable	(1,357,506)	(421,603)
Accrued compensation and benefits	(99,861)	56,473
Other accrued expenses	(288,821)	247,625
Income taxes payable	(59,368)	1,552,228
Net cash provided by operating activities	<u>8,252,041</u>	<u>4,977,262</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(1,635,893)	(1,190,886)
Purchases of investments	(16,156,015)	(17,110,186)
Acquisition of business, net of cash acquired	(2,408,910)	—
Proceeds from the sale of fixed assets	8,055	27,593
Proceeds from the sale of investments	19,174,385	10,176,299
Net cash used in investing activities	<u>(1,018,378)</u>	<u>(8,097,180)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash dividends paid	(3,795,989)	(3,598,544)
Mortgage principal payments	(296,844)	(277,300)
Proceeds from issuance of common stock	177,609	100,337
Excess tax benefit from stock based payments	23,227	—
Net cash used in financing activities	<u>(3,891,997)</u>	<u>(3,775,507)</u>
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	<u>(44,619)</u>	<u>(31,841)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,297,047	(6,927,266)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>16,787,558</u>	<u>21,293,448</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 20,084,605</u>	<u>\$ 14,366,182</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income taxes paid	\$ 6,996,908	\$ 3,473,805
Interest paid	121,615	153,249
Dividends declared not paid	1,269,155	1,259,940
Acquisition costs in accrued expenses	1,681,367	—

COMMUNICATIONS SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Communications Systems, Inc. (herein collectively called “CSI” or the “Company”) is a Minnesota corporation organized in 1969 which operates directly and through its subsidiaries located in the United States, Costa Rica, the United Kingdom and China. CSI is principally engaged through its Suttle and Austin Taylor business units in the manufacture and sale of modular connecting and wiring devices for voice and data communications, digital subscriber line filters, and structured wiring systems and through its Transition Networks business unit in the manufacture of media and rate conversion products for telecommunications networks. CSI also provides through its JDL Technologies (“JDL”) business unit IT solutions including network design, computer infrastructure installations, IT service management, change management, network security and network operations services.

Financial Statement Presentation

The condensed consolidated balance sheets and condensed consolidated statement of changes in stockholders’ equity as of September 30, 2011 and 2010 and the related condensed consolidated statements of income and comprehensive income (loss), and the condensed consolidated statements of cash flows for the periods ended September 30, 2011 and 2010 have been prepared by Company management. In the opinion of management, all adjustments (which include only normal recurring adjustments except where noted) necessary to present fairly the financial position, results of operations, and cash flows at September 30, 2011 and 2010 and for the periods then ended have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. We recommend these condensed consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company’s December 31, 2010 Annual Report to Shareholders on Form 10-K. The results of operations for the periods ended September 30, 2011 are not necessarily indicative of operating results for the entire year.

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the balance sheet date, and the reported amounts of revenues and expenses during the reporting period. The estimates and assumptions used in the accompanying condensed consolidated financial statements are based upon management’s evaluation of the relevant facts and circumstances as of the time of the financial statements. Actual results could differ from those estimates.

Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010, appropriately represent, in all material respects, the current status of accounting policies, and are incorporated herein by reference.

Cash Equivalents and Investments

For purposes of the condensed consolidated balance sheets and statements of cash flows, the Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents. As of September 30, 2011, the Company had \$20.1 million in cash and cash equivalents. Of this amount, \$1.1 million was invested in short-term money market funds that are not considered to be bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation ("FDIC") or other government agency. These money market funds seek to preserve the value of the investment at \$1.00 per share; however, it is possible to lose money investing in these funds.

The remainder of the Company's cash and cash equivalents is deposited at banks. The FDIC insures deposits at banks up to \$250,000 per account. The Company's cash and cash equivalents are held at large, well-established financial institutions and the Company believes any risk associated with uninsured balances is remote.

The Company had \$23.2 million in investments, which consist of certificates of deposit that were purchased in the public markets and are classified as available-for-sale at September 30, 2011. Of the \$23.2 million in investments, \$18.8 million mature in 12 months or less and are classified as current assets. Available-for-sale investments are reported at fair value with unrealized gains and losses net of tax excluded from operations and reported as a separate component of stockholders' equity (See Accumulated Other Comprehensive Income (Loss) below).

Revenue Recognition

The Company's manufacturing operations (Suttle, Transition Networks and Austin Taylor) recognize revenue when the earnings process is complete, evidenced by persuasive evidence of an agreement, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. Revenue is recognized for domestic and international sales at the shipping point or delivery to customers, based on the related shipping terms. Risk of loss transfers at the point of shipment or delivery to customers, and the Company has no further obligation after this time. Sales are made directly to customers and through distributors. Payment terms for distributors are consistent with the terms of the Company's direct customers. The Company records a provision for sales returns, sales incentives and warranty costs at the time of the sale based on historical experience and current trends.

JDL generally records revenue on hardware, software and related equipment sales and installation contracts when the revenue recognition criteria are met and products are installed and accepted by the customer. JDL records revenue on service contracts on a straight-line basis over the contract period, unless evidence suggests the revenue is earned in a different pattern. Each contract is individually reviewed to determine when the earnings process is complete.

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss), net of tax, are as follows:

	September 30 2011	December 31 2010
Foreign currency translation	\$ (1,317,010)	\$ (1,272,530)
Unrealized gain (loss) on available-for-sale investments	(16,452)	14,058
Minimum pension liability	945,883	972,835
	<u>\$ (387,579)</u>	<u>\$ (285,637)</u>

NOTE 2 - STOCK-BASED COMPENSATION

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan ("ESPP") employees are able to acquire shares of common stock at 90% of the price at the end of each current quarterly plan term. The most recent term ended September 30, 2011. The ESPP is considered compensatory under current rules. At September 30, 2011, after giving effect to the shares issued as of that date, 70,072 shares remain available for purchase under the ESPP.

2011 Executive Incentive Compensation Plan

On March 28, 2011 the Board adopted and on May 19, 2011 the Company's shareholders approved the Company's 2011 Executive Incentive Compensation Plan ("2011 Incentive Plan"). The 2011 Incentive Plan authorizes incentive awards to officers, key employees and non-employee directors in the form of options (incentive and non-qualified), stock appreciation rights, restricted stock, restricted stock units, performance stock units ("deferred stock"), performance cash units, and other awards in stock, cash, or a combination of stock and cash. Up to 1,000,000 shares of our Common Stock may be issued pursuant to awards under the 2011 Incentive Plan. Through September 30, 2011, the only awards that have been made under the 2011 Incentive Plan are those described in following paragraphs.

The 2011 Incentive Plan permits equity awards to non-employee directors either in the form of restricted stock grants or non-qualified stock option awards, or both. On March 28, 2011, the Compensation Committee and the Board determined that, subject to receiving shareholder approval of the 2011 Incentive Plan, each non-employee director elected or re-elected at the May 19, 2011 Annual Shareholders Meeting (the "2011 Shareholders Meeting") would be issued shares of restricted stock having a value of \$40,000 based on the closing price of the Company's common stock on May 19, 2011 and also determined this restricted stock would vest after one year and be subject to restrictions on resale for one additional year. At the 2011 Shareholders Meeting, the Company's shareholders approved the 2011 Incentive Plan and, effective as of that date, the Company awarded 2,226 shares of restricted stock to each of the Company's six non-employee directors for a total of 13,356 shares. In addition, on August 11, 2011, the Company's Board awarded a 2,226 share restricted stock grant to the Company's former chief executive officer, who began service as a non-employee director after retiring as chief executive officer on May 19, 2011.

During the third quarter of 2011, stock options were awarded covering 6,640 shares to key executive employees, which options expire seven years from the date of award and vest 25% each year beginning one year after the date of award. The Company also granted deferred stock awards of 3,450 shares to key employees during the third quarter under the Company's performance unit plan for performance over the 2011 to 2013 period. The actual number of shares of deferred stock earned by the respective employees, if any, will be determined based on achievement against cumulative performance goals for the three years ending December 31, 2013 and the number of shares earned will be paid in the first quarter of 2014 to those key employees still with the Company at that time.

At September 30, 2011, 974,328 shares remained available to be issued under the 2011 Incentive Plan.

Stock Option Plan for Directors

Shares of common stock are reserved for issuance to non-employee directors under options granted by the Company prior to 2011 under its Stock Option Plan for Non-Employee Directors (the "Director Plan"). Under the Director Plan nonqualified stock options to acquire 3,000 shares of common stock were automatically granted to each non-employee director concurrent with annual meetings of shareholders in 2010 and earlier years, with the exercise price of options granted being the fair market value of the common stock on the date of the respective shareholder meetings. Options granted under the Director Plan expire 10 years from date of grant.

No options have been granted under the Director Plan in 2011. The Director Plan was amended as of May 19, 2011 to prohibit automatic option grants in 2011 and future years to fulfill a commitment made by the Company in connection with seeking shareholder approval of the 2011 Incentive Plan at the 2011 Annual Meeting of Shareholders that, if shareholder approval was received, it would amend the Director Plan to prohibit any future option awards under that plan.

Stock Plan

Under the Company's 1992 Stock Plan ("the Stock Plan"), shares of common stock may be issued pursuant to stock options, restricted stock or deferred stock grants to officers and key employees. Exercise prices of stock options under the Stock Plan cannot be less than fair market value of the stock on the date of grant. Rules and conditions governing awards of stock options, restricted stock and deferred stock are determined by the Compensation Committee of the Board of Directors, subject to certain limitations in the Stock Plan.

During the first quarter of 2011, stock options were awarded covering 89,610 shares to key executive employees, which options expire seven years from the date of award and vest 25% each year beginning one year after the date of award.

During the first quarter of 2011, key employees were granted 16,092 shares of deferred stock based on achievement against performance goals in 2010 under the Company's performance unit plan. The deferred stock will be paid out in the first quarter of 2014 to key employees still employed by the Company at that time. The Company also granted deferred stock awards of 73,972 shares to key employees under the Company's performance unit plan for performance over the 2011 to 2013 period. The actual number of shares of deferred stock earned by the respective employees, if any, will be determined based on achievement against cumulative performance goals for the three years ending December 31, 2013 and the number of shares earned will be paid in the first quarter of 2014 to those key employees still employed by the Company at that time. During the first quarter, the Company also granted deferred stock awards of up to 11,618 shares to executive employees that will be earned under the Company's short-term incentive plan if actual revenue growth equals or exceeds 150% of the revenue growth target for 2011. The number of shares earned by the respective executive employees, if any, will be paid out in the first quarter of 2012.

At September 30, 2011 the only shares that are available for issuance under the Stock Plan are the 191,292 shares reserved for issuance under the stock options and deferred stock awards described in the two preceding paragraphs. When seeking approval of the 2011 Incentive Plan at the 2011 Shareholders Meeting, the Company committed to prohibit the issuance of any future equity awards under the Stock Plan on or after May 19, 2011, other than the 191,292 reserved shares which are available to be issued as deferred stock awards or options.

Changes in Stock Options Outstanding

The following table summarizes changes in the number of outstanding stock options under the Director Plan and Stock Plan over the period December 31, 2010 to September 30, 2011. All stock options outstanding at December 31, 2010 are exercisable and 17,635 of the options awarded during the nine month period ended September 30, 2011 are exercisable.

	Options	Weighted average exercise price per share	Weighted average remaining contractual term
Outstanding – December 31, 2010	162,000	\$ 9.49	5.33 years
Awarded	96,250	14.16	
Exercised	(9,000)	8.10	
Canceled	(12,430)	11.23	
Outstanding – September 30, 2011	236,820	11.35	5.43 years

The aggregate intrinsic value of all options (the amount by which the market price of the stock on the last day of the period exceeded the market price of the stock on the date of grant) outstanding at September 30, 2011 was \$495,000. The intrinsic value of all options exercised during the nine months ended September 30, 2011 was \$61,000. Net cash proceeds from the exercise of all stock options were \$73,000 and \$0 for the nine months ended September 30, 2011 and 2010, respectively.

Changes in Deferred Stock Outstanding

The following table summarizes the changes in the number of deferred stock shares under the Stock Plan and 2011 Incentive Plan over the period December 31, 2010 to September 30, 2011:

	Shares	Weighted Average Grant Date Fair Value
Outstanding – December 31, 2010	—	\$ —
Granted	105,132	15.15
Vested	(2,083)	15.40
Canceled	(5,833)	15.27
Outstanding – September 30, 2011	97,216	15.14

Compensation Expense

Share-based compensation expense recognized for the nine month period ended September 30, 2011 was \$413,000 before income taxes and \$269,000 after income taxes. Share-based compensation expense recognized for the nine month period ended September 30, 2010 was \$39,000 before income taxes and \$25,000 after income taxes. Unrecognized compensation expense for the Company's plans was \$623,000 at September 30, 2011. Excess tax benefits from the exercise of stock options included in financing cash flows for the nine month periods ended September 30, 2011 and 2010 were \$23,000 and \$0, respectively. Share-based compensation expense is recorded as a part of selling, general and administrative expenses.

NOTE 3 - INVENTORIES

Inventories summarized below are priced at the lower of first-in, first-out cost or market:

	September 30 2011	December 31 2010
Finished goods	\$ 14,183,482	\$ 13,684,884
Raw and processed materials	11,828,651	10,814,051
Total	<u>\$ 26,012,133</u>	<u>\$ 24,498,935</u>

NOTE 4 – ACQUISITION

On July 27, 2011, the Company acquired Patapsco Designs Limited of the UK (“Patapsco”). The purchase price totals \$5,031,000, with cash acquired totaling \$862,000. The purchase price includes initial consideration of \$3,271,000, deferred consideration of \$491,000 to be paid out no later than 18 months from the acquisition date, \$656,000 in working capital adjustments, and \$613,000 in contingent consideration. The Company has agreed to pay consideration up to \$818,000 contingent upon the Patapsco business meeting gross margin and other non-financial targets, with the consideration to be paid out no later than two years from the acquisition date. Although the maximum contingent consideration is \$818,000, the Company has recognized \$613,000 as the estimated fair value of the contingent consideration at the date of acquisition. This contingent consideration has been calculated based on the exchange rate at the date of acquisition and actual payments may differ based on fluctuations in the exchange rate between the dollar and the pound. At September 30, 2011, the Company had estimated liabilities of \$1,681,000 related to outstanding consideration payments.

The estimated assets and liabilities of Patapsco were recorded in the consolidated balance sheet within the Transition Networks segment at September 30, 2011. The preliminary purchase price allocation was based on estimates of the fair value of assets acquired and liabilities assumed and included total assets of \$5,864,000, including estimated goodwill of \$2,032,000 and estimated intangibles of \$1,616,000, and total liabilities of \$833,000. All balances recorded are estimated amounts; the purchase price allocation will be finalized subsequent to the third quarter as the valuation of identifiable assets and liabilities is completed. The pro forma impact of Patapsco was not significant to the Company’s results for the three and nine months ended September 30, 2011.

NOTE 5 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is required to be evaluated for impairment on an annual basis and between annual tests upon the occurrence of certain events or circumstances. A two-step process is performed to analyze whether or not goodwill has been impaired. Step one is to test for potential impairment, and requires that the fair value of the reporting unit be compared to its book value including goodwill. If the fair value is higher than the book value, no impairment is recognized. If the fair value is lower than the book value, a second step must be performed. The second step is to measure the amount of impairment loss, if any, and requires that a hypothetical purchase price allocation be done to determine the implied fair value of goodwill. This fair value is then compared to the carrying value of goodwill. If the implied fair value is lower than the carrying value, an impairment adjustment must be recorded.

During our fiscal quarter ended June 30, 2011, based on greater than expected decline in actual and forecasted profitability of legacy products in our Suttle business unit, as well as, significant project delays that occurred related to Suttle's new technologies, we concluded that that these events and circumstances were indicators to require us to perform an interim goodwill impairment analysis of our Suttle business unit. This analysis included the determination of the reporting unit's fair value primarily using discounted cash flows modeling. Based on the step one and step two analysis, considering Suttle's reduced earnings and cash flow forecasts, the Company determined that Suttle's goodwill was fully impaired and recorded a goodwill impairment for the Suttle segment of \$1,272,000. The changes in the carrying amount of goodwill for the nine months ended September 30, 2011 by segment is as follows:

	Suttle	Transition Networks	Total
January 1, 2010	\$ 1,271,986	\$ 3,288,231	\$ 4,560,217
December 31, 2010	1,271,986	3,288,231	4,560,217
Impairment loss	(1,271,986)		(1,271,986)
Acquisition		2,032,476	2,032,476
September 30, 2011	\$ —	\$ 5,320,707	\$ 5,320,707
Gross goodwill	\$ 1,271,986	\$ 5,320,707	\$ 6,592,693
Accumulated impairment loss	\$ (1,271,986)		(1,271,986)
Balance at September 30, 2011	\$ —	\$ 5,320,707	\$ 5,320,707

NOTE 6 – WARRANTY

We provide reserves for the estimated cost of product warranties at the time revenue is recognized. We estimate the costs of our warranty obligations based on our warranty policy or applicable contractual warranty, historical experience of known product failure rates, and use of materials and service delivery costs incurred in correcting product failures. Management reviews the estimated warranty liability on a quarterly basis to determine its adequacy. The actual warranty expense could differ from the estimates made by the Company based on product performance.

The following table presents the changes in the Company's warranty liability for the nine month periods ended September 30, 2011 and 2010, respectively, the majority of which relates to a five-year obligation to provide for potential future liabilities for network equipment sales.

	2011	2010
Beginning Balance	\$ 616,000	\$ 648,000
Actual warranty costs paid	(180,000)	(154,000)
Amounts charged to expense	197,000	86,000
Ending balance	\$ 633,000	\$ 580,000

NOTE 7 – CONTINGENCIES

In the ordinary course of business, the Company is exposed to legal actions and claims and incurs costs to defend against these actions and claims. Company management is not aware of any outstanding or pending legal actions or claims that would materially affect the Company's financial position or results of operations.

NOTE 8 – INCOME TAXES

In the preparation of the Company's consolidated financial statements, management calculates income taxes based upon the estimated effective rate applicable to operating results for the full fiscal year. This includes estimating the current tax liability as well as assessing differences resulting from different treatment of items for tax and book accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be recovered from future taxable income.

At September 30, 2011 there was \$517,000 of net uncertain tax benefit positions that would reduce the effective income tax rate if recognized. The Company records interest and penalties related to income taxes as income tax expense in the Condensed Consolidated Statements of Income.

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The tax years 2008-2010 remain open to examination by the Internal Revenue Service and the years 2007-2010 remain open to examination by various state tax departments. The tax years from 2008-2009 remain open in Costa Rica.

The Company's effective income tax rate was 42.4% for the first nine months of 2011. The effective tax rate differs from the federal tax rate of 35% due to state income taxes, return to provision adjustments, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges, settlement of uncertain income tax positions, acquisition-related costs and goodwill impairment not deductible for U.S. income tax purposes. The foreign operating losses may ultimately be deductible in the countries in which they have occurred; however the Company has not recorded a deferred tax asset for these losses due to uncertainty regarding the eventual realization of the benefit. The effect of the foreign operations is an overall rate increase of approximately 1.5% for the nine months ended September 30, 2011. Additionally, the effect of the goodwill impairment is an overall rate increase of 2.4% for the nine months ended September 30, 2011. There were no additional uncertain tax positions identified in the third quarter of 2011. The Company's effective income tax rate for the nine months ended September 30, 2010 was 38.7%, and differed from the federal tax rate due to state income taxes, foreign losses not deductible for U.S. income tax purposes, return to provision adjustments, provisions for interest charges, and settlement of uncertain tax positions.

NOTE 9 – SEGMENT INFORMATION

The Company classifies its businesses into four segments as follows:

- Suttle manufactures and sells U.S. standard modular connecting and wiring devices for voice and data communications, digital subscriber line filters, and structured wiring systems;

- Transition Networks designs and markets data transmission, computer network and media conversion products;
- JDL Technologies, Inc. provides IT services including network design, computer infrastructure installations, IT service management, change management, network security and network operations services;
- Austin Taylor Communications LTD manufactures British-standard telephone equipment and equipment enclosures for the U.K and international markets.

Our non-allocated corporate general and administrative expenses are categorized as "Other" in the Company's segment reporting. Management has chosen to organize the enterprise and disclose reportable segments based on our products and services. There are no material inter-segment revenues.

Information concerning the Company's continuing operations in the various segments for the three and nine month periods ended September 30, 2011 and 2010 is as follows:

SEGMENT INFORMATION - THREE MONTHS

	Suttle	Transition Networks	JDL Technologies	Austin Taylor	Other	Total
Three months ended September 30, 2011:						
Sales	\$ 9,557,670	\$ 27,573,925	\$ 3,872,368	\$ 980,607	\$ —	\$ 41,984,570
Cost of sales	7,233,772	14,845,981	2,403,383	946,164	—	25,429,300
Gross profit	2,323,898	12,727,944	1,468,985	34,443	—	16,555,270
Selling, general and administrative expenses	1,690,716	6,017,085	522,104	436,995	1,404,508	10,071,408
Goodwill impairment	—	—	—	—	—	—
Operating income (loss)	\$ 633,182	\$ 6,710,859	\$ 946,881	\$ (402,552)	\$ (1,404,508)	\$ 6,483,862
Depreciation and amortization	\$ 245,870	\$ 184,712	\$ 23,621	\$ 12,095	\$ 70,984	\$ 537,282
Capital expenditures	\$ 255,232	\$ 348,129	\$ 4,572	\$ 29,105	\$ 29,942	\$ 666,980
Assets at September 30, 2011	\$ 22,573,483	\$ 38,084,903	\$ 2,616,360	\$ 2,265,011	\$ 51,173,848	\$ 116,713,605

	Suttle	Transition Networks	JDL Technologies	Austin Taylor	Other	Total
Three months ended September 30, 2010:						
Sales	\$ 9,069,600	\$ 18,991,587	\$ 4,463,475	\$ 799,131	\$ —	\$ 33,323,793
Cost of sales	6,634,125	8,400,497	2,302,883	676,304	—	18,013,809
Gross profit	2,435,475	10,591,090	2,160,592	122,827	—	15,309,984
Selling, general and administrative expenses	1,730,506	5,452,714	346,899	324,672	1,150,908	9,005,699
Operating income (loss)	\$ 704,969	\$ 5,138,376	\$ 1,813,693	\$ (201,845)	\$ (1,150,908)	\$ 6,304,285
Depreciation and amortization	\$ 187,636	\$ 158,071	\$ 11,709	\$ 8,952	\$ 73,669	\$ 440,037
Capital expenditures	\$ (3,387)	\$ 193,763	\$ —	\$ 20,961	\$ 84,063	\$ 295,400
Assets at September 30, 2010	\$ 19,677,651	\$ 31,467,598	\$ 4,205,027	\$ 2,919,046	\$ 50,128,264	\$ 108,397,586

SEGMENT INFORMATION - NINE MONTHS

	Suttle	Transition Networks	JDL Technologies	Austin Taylor	Other	Total
Nine months ended September 30, 2011:						
Sales	\$ 27,504,276	\$ 76,507,810	\$ 11,654,074	\$ 2,770,897	\$ —	\$ 118,437,057
Cost of sales	20,662,922	40,265,114	6,680,401	2,489,276	—	70,097,713
Gross profit	6,841,354	36,242,696	4,973,673	281,621	—	48,339,344
Selling, general and administrative expenses	5,125,669	17,246,437	1,523,049	1,044,941	4,249,282	29,189,378
Goodwill impairment	1,271,986	—	—	—	—	1,271,986
Operating income (loss)	\$ 443,699	\$ 18,996,259	\$ 3,450,624	\$ (763,320)	\$ (4,249,282)	\$ 17,877,980
Depreciation and amortization	\$ 707,534	\$ 526,474	\$ 80,927	\$ 36,225	\$ 220,263	\$ 1,571,423
Capital expenditures	\$ 838,033	\$ 699,235	\$ 15,947	\$ 43,693	\$ 38,985	\$ 1,635,893

	Suttle	Transition Networks	JDL Technologies	Austin Taylor	Other	Total
Nine months ended September 30, 2010:						
Sales	\$ 28,121,860	\$ 49,863,982	\$ 9,384,330	\$ 2,494,456	\$ —	\$ 89,864,628
Cost of sales	20,612,293	22,686,238	5,199,168	2,257,876	—	50,755,575
Gross profit	7,509,567	27,177,744	4,185,162	236,580	—	39,109,053
Selling, general and administrative expenses	5,364,176	15,772,091	1,055,247	853,435	3,447,631	26,492,580
Operating income (loss)	\$ 2,145,391	\$ 11,405,653	\$ 3,129,915	\$ (616,855)	\$ (3,447,631)	\$ 12,616,473
Depreciation and amortization	\$ 623,479	\$ 456,335	\$ 88,517	\$ 29,679	\$ 220,055	\$ 1,418,065
Capital expenditures	\$ 501,425	\$ 473,015	\$ 16,947	\$ 35,354	\$ 164,145	\$ 1,190,886

NOTE 10 – PENSIONS

The Company's U.K. based subsidiary Austin Taylor maintains defined benefit pension plans that cover seven active employees. The Company does not provide any other post-retirement benefits to its employees. Components of net periodic benefit cost of the pension plans were:

	Nine months Ended September 30	
	2011	2010
Service cost	\$ 35,000	27,000
Interest cost	196,000	194,000
Expected return on plan assets	(185,000)	(168,000)
	\$ 46,000	\$ 53,000

NOTE 11 – NET INCOME PER SHARE

Basic net income per common share is based on the weighted average number of common shares outstanding during each year. Diluted net income per common share takes into effect the dilutive effect of potential common shares outstanding. The Company's only potential common shares outstanding are stock options and shares associated with the long-term incentive compensation plans, which resulted in a dilutive effect of 69,562 shares and 57,210 shares for the respective three and nine month periods ended September 30, 2011. The dilutive effect of stock options for the three and nine month periods ended September 30, 2010 was 16,369 shares and 24,670 shares, respectively. The Company calculates the dilutive effect of outstanding options using the treasury stock method. All options were included because the exercise price was greater than the average market price of common stock during the period and deferred stock awards totaling 78,943 shares were not included because of unmet performance conditions.

NOTE 12 – FAIR VALUE MEASUREMENTS

The accounting guidance establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 – Observable inputs that reflect unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access at the measurement date.

Level 2 – Observable inputs such as quoted prices for similar instruments and quoted prices in markets that are not active, and inputs that are directly observable or can be corroborated by observable market data. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, such as treasury securities with pricing interpolated from recent trades of similar securities, or priced with models using highly observable inputs, such as commodity options priced using observable forward prices and volatilities.

Level 3 – Significant inputs to pricing that have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those with inputs requiring significant management judgment or estimation, such as the complex and subjective models and forecasts used to determine the fair value of financial instruments.

The Company's assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010, respectively, include money market funds within cash and cash equivalents of \$1,074,000 and \$9,624,000 classified as Level 1 within the hierarchy and certificate of deposits within investments of \$23,238,000 and \$26,287,000 classified as Level 2. The Company does not have any assets or liabilities classified as Level 3 within the hierarchy. There were no transfers between levels during the nine months ended September 30, 2011.

NOTE 13 – SUBSEQUENT EVENTS

On October 28, 2011, the Company entered into a new \$10,000,000 line of credit agreement with Wells Fargo Bank. Interest on borrowings on the credit line is at the LIBOR rate plus 1.1%. The credit agreement expires October 31, 2013 and is secured by assets of the Company.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking statements

In this report and, from time to time, in reports filed with the Securities and Exchange Commission, in press releases, and in other communications to shareholders or the investing public, the Company may make "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 concerning possible or anticipated future financial performance, business activities, plans, pending claims, investigations or litigation which are typically preceded by the words "believes," "expects," "anticipates," "intends" or similar expressions. For these forward-looking statements, the Company claims the protection of the safe harbor for forward-looking statements contained in federal securities laws. Shareholders and the investing public should understand that these forward-looking statements are subject to risks and uncertainties that could cause actual performance, activities, anticipated results, outcomes or plans to differ significantly from those indicated in the forward-looking statements. These risks and uncertainties include, but are not limited to:

- our ability to manufacture and deliver our products to customers in the time frame these customers have specified;
- possible lower future sales to major telephone companies and other major customers;
- the introduction of competitive products and technologies;
- our ability to successfully reduce operating expenses at certain business units;
- the general health of the telecom sector;
- the continuing worldwide financial downturn and sluggish economic conditions in certain market segments;
- our ability to successfully and profitably integrate our acquisitions, including our July 27, 2011 acquisition of Patapsco;
- delays in new product introductions;
- higher than expected expense related to new sales and marketing initiatives;
- unfavorable resolution of claims and litigation;
- availability of adequate supplies of raw materials and components;
- fuel prices;
- government funding of education technology spending; and
- other factors discussed from time to time in the Company's filings with the Securities and Exchange Commission, including risk factors presented under Item 1A of the Company's most recently filed annual report on Form 10-K.

Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010

Consolidated sales increased 26% in 2011 to \$41,985,000 compared to \$33,324,000 in 2010. Consolidated operating income in 2011 increased to \$6,484,000 compared to \$6,304,000 in the third quarter of 2010.

Net income in 2011 decreased to \$3,730,000 compared to \$3,999,000 in the third quarter of 2010.

Suttle

Suttle sales increased 5% in the third quarter of 2011 to \$9,558,000 compared to \$9,070,000 in the same period of 2010 due to an increase in sales of structured cabling products. Sales by customer groups in the third quarter of 2011 and 2010 were:

	Suttle Sales by Customer Group	
	2011	2010
Major telephone companies	\$ 7,415,000	\$ 6,618,000
Distributors	1,106,000	1,327,000
International	1,019,000	1,120,000
Other	18,000	5,000
	<u>\$ 9,558,000</u>	<u>\$ 9,070,000</u>

Suttle's sales by product groups in third quarter of 2011 and 2010 were:

	Suttle Sales by Product Group	
	2011	2010
Modular connecting products	\$ 3,271,000	\$ 3,378,000
DSL products	2,520,000	2,882,000
Structured cabling products	3,418,000	2,725,000
Other products	349,000	85,000
	<u>\$ 9,558,000</u>	<u>\$ 9,070,000</u>

Sales to the major telephone companies increased 12% in 2011 due to an increase in sales of structured cabling products. Sales to these customers accounted for 78% of Suttle's sales in the third quarter of 2011 compared to 73% of sales in 2010. Sales to distributors decreased 17% in 2011 due to continued declines in legacy markets. This customer segment accounted for 12% and 15% of sales in the third quarters of 2011 and 2010, respectively. International sales decreased 9% and accounted for 11% of Suttle's third quarter 2011 sales.

Modular connecting products sales decreased 3% due to continued decline in the voice market. Sales of DSL products decreased 13% due to the maturation of the U.S. DSL market and the order cycle of major customers. Sales of structured cabling products increased 25% due to an adoption of Suttle's products in new regions supported by key service provider.

Suttle's gross margin decreased 5% in the third quarter of 2011 to \$2,324,000 compared to \$2,435,000 in the same period of 2010. Gross margin as a percentage of sales decreased to 24% in 2011 from 27% in 2010 due to product mix changes and rising input costs. Selling, general and administrative expenses decreased \$40,000 or 2% in the third quarter of 2011 compared to the same period in 2010, due to cost control measures during the quarter. Suttle's operating income was \$633,000 in the third quarter of 2011 compared to \$705,000 in 2010.

Transition Networks

Transition Networks sales increased 45% to \$27,574,000 in the third quarter of 2011 compared to \$18,992,000 in 2010.

Third quarter sales by region are presented in the following table:

	Transition Networks Sales by Region	
	2011	2010
North America	\$ 24,470,000	\$ 16,213,000
Europe, Middle East, Africa (“EMEA”)	1,065,000	1,216,000
Rest of world (“ROW”)	2,039,000	1,563,000
	<u>\$ 27,574,000</u>	<u>\$ 18,992,000</u>

The following table summarizes Transition Networks’ 2011 and 2010 third quarter sales by its major product groups:

	Transition Networks Sales by Product Group	
	2011	2010
Media converters	\$ 22,944,000	\$ 13,973,000
Ethernet switches	1,087,000	1,256,000
Ethernet adapters	1,924,000	2,371,000
Other products	1,619,000	1,392,000
	<u>\$ 27,574,000</u>	<u>\$ 18,992,000</u>

Sales in North America increased 51% or \$8,527,000 due to \$13,364,000 in revenue from a one-time large network upgrade project with a Fortune 500 company. Sales to this customer also resulted in the increase in media converter revenue. This upgrade began in the second quarter and was substantially complete as of the end of the third quarter. The increase in revenue from this customer was partially offset by a decrease in sales to some of Transition Networks’ traditional other customers. Other vertical markets, especially the Federal Government market in the United States, recorded lower revenue due to the slow down in government purchases resulting in project delays. International sales increased \$325,000, or 12%, due to growth in the ROW market as well as additional revenues from the recent acquisition of Patapsco.

Gross margin on third quarter Transition Networks’ sales increased 20% to \$12,728,000 in 2011 from \$10,591,000 in 2010. Gross margin as a percentage of sales decreased to 46% in 2011 from 56% in 2010 due to volume discounts given for the large network upgrade project with the Fortune 500 company described above. Selling, general and administrative expenses increased 10% to \$6,017,000 in 2011 compared to \$5,453,000 in 2010 due to an increase in research and development expenses. Operating income increased to \$6,711,000 in 2011 compared to \$5,138,000 in 2010.

JDL Technologies, Inc.

JDL Technologies, Inc. sales decreased 13% to \$3,872,000 in the third quarter of 2011 compared to \$4,463,000 in 2010.

JDL's revenues by customer group were as follows:

	JDL Revenue by Customer Group	
	2011	2010
Broward County FL schools	\$ 3,691,000	\$ 4,380,000
All other	181,000	83,000
	<u>\$ 3,872,000</u>	<u>\$ 4,463,000</u>

Revenues earned in Broward County, Florida decreased \$591,000 or 16% in the third quarter 2011. In the first quarter of 2010, the Company received significant funding for federal government contract work. This contract work was of a long-term nature, and the Company completed these contracts during the quarter ended September 30, 2011.

JDL gross margin decreased 32% to \$1,469,000 in the third quarter of 2011 compared to \$2,161,000 in the same period in 2010. Gross margin as a percentage of sales decreased to 38% in 2011 from 48% in 2010 due to a decrease in purchasing discounts during the quarter. Selling, general and administrative expenses increased in 2011 to \$522,000 compared to \$347,000 in 2010 due to headcount increases, specifically within the sales function as JDL has expanded its market focus. JDL reported operating income of \$947,000 in the third quarter of 2011 compared to \$1,814,000 in the same period of 2010.

Austin Taylor

Austin Taylor's revenues increased 23% to \$981,000 for the third quarter of 2011, compared to \$799,000 in 2010. This revenue increase is due to high volume sales of metal cabinets and frames into the UK and European market and an increase in contracted original equipment manufacturer ("OEM") sales. Gross margin decreased to \$34,000 in 2011 from \$123,000 in 2010. Gross margin as a percentage of sales was 4% in 2011 compared to 15% in 2010. This margin decrease is directly related to the increase of metal cabinet and frame sales. Austin Taylor reported an operating loss in 2011 of \$403,000 compared to a loss of \$202,000 in 2010.

Other

The Company's income before income taxes increased to \$6,575,000 in 2011 compared to \$6,354,000 in 2010. The Company's effective income tax rate was 43% in 2011 and 37% in 2010. This effective rate was higher than the standard rate of 35% due to state income taxes, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges and acquisition costs not deductible for income tax purposes.

Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010

Consolidated sales increased 32% in 2011 to \$118,437,000 compared to \$89,865,000 in 2010. Consolidated operating income in 2011 increased to \$17,878,000 compared to \$12,616,000 in the first nine months of 2010.

Net income in 2011 increased to \$10,372,000 compared to \$7,746,000 in the first nine months of 2010.

Suttle

Suttle sales decreased 2% in the first nine months of 2011 to \$27,504,000 compared to \$28,122,000 in the same period of 2010. Sales by customer groups in the first nine months of 2011 and 2010 were:

	Suttle Sales by Customer Group	
	2011	2010
Major telephone companies	\$ 20,049,000	\$ 19,678,000
Distributors/OEMs	3,334,000	4,130,000
International	3,825,000	4,220,000
Other	296,000	94,000
	<u>\$ 27,504,000</u>	<u>\$ 28,122,000</u>

Suttle's sales by product groups in first nine months of 2011 and 2010 were:

	Suttle Sales by Product Group	
	2011	2010
Modular connecting products	\$ 9,533,000	\$ 11,186,000
DSL products	7,836,000	8,930,000
Structured cabling products	8,795,000	7,566,000
Other products	1,340,000	440,000
	<u>\$ 27,504,000</u>	<u>\$ 28,122,000</u>

Sales to the major telephone companies increased 2% in 2011 due to an increase in sales of structured cabling products. Sales to these customers accounted for 73% of Suttle's sales in the first nine months of 2011 compared to 70% of sales in the same period in 2010. Sales to distributors, original equipment manufacturers ("OEMs"), and electrical contractors decreased 19% in 2011 primarily due to continued challenges in the U.S. housing market. This customer segment accounted for 12% and 15% of sales in the first nine months of 2011 and 2010, respectively. International sales decreased 9% and accounted for 14% of Suttle's first nine months 2011 sales. Sales to other customers increased 215% to \$296,000.

Modular connecting products sales have decreased 15% due to a slowing of the home building business and continued decline in the voice market. Sales of DSL products decreased 12% due to the maturation of the U.S. DSL market and order cycles of major customers. Sales of structured cabling products increased 16% due to an adoption of Suttle's products in new regions supported by key service provider.

Suttle's gross margin decreased 9% in the first nine months of 2011 to \$6,841,000 compared to \$7,510,000 in the same period of 2010. Gross margin as a percentage of sales decreased to 25% in 2011 from 27% in 2010 due to product mix changes and rising input costs. Selling, general and administrative expenses decreased \$238,000 or 4% in the first nine months of 2011 compared to the same period in 2010, due to cost control measures during the first nine months of the year. Suttle's operating income was \$444,000 in the first nine months of 2011 compared to \$2,145,000 in 2010 due in part to the margin erosion mentioned above and a goodwill impairment charge of \$1,272,000 in the second quarter of 2011.

Transition Networks

Transition Networks sales increased 53% to \$76,508,000 in the first nine months of 2011 compared to \$49,864,000 in 2010.

First nine months sales by region are presented in the following table:

	Transition Networks Sales by Region	
	2011	2010
North America	\$ 66,770,000	\$ 41,737,000
Europe, Middle East, Africa (“EMEA”)	4,394,000	3,292,000
Rest of world	5,344,000	4,835,000
	<u>\$ 76,508,000</u>	<u>\$ 49,864,000</u>

The following table summarizes Transition Networks’ 2011 and 2010 first nine months sales by its major product groups:

	Transition Networks Sales by Product Group	
	2011	2010
Media converters	\$ 62,370,000	\$ 37,176,000
Ethernet switches	3,362,000	3,153,000
Ethernet adapters	4,824,000	5,692,000
Other products	5,952,000	3,843,000
	<u>\$ 76,508,000</u>	<u>\$ 49,864,000</u>

Sales in North America increased 60% or \$25,033,000 due to \$32,751,000 in revenue from a one-time large network upgrade project with a Fortune 500 company. Sales to this customer also resulted in the increase in media converter revenue. As described above under the Transition Networks’ results for the three months ended September 30, 2011, this upgrade began in the second quarter and has been substantially completed as of September 30, 2011. Other vertical markets, especially the Federal Government market in the United States, recorded lower revenue due to the slow down in government purchases resulting in project delays. International sales increased \$1,611,000, or 20% primarily due to improved economic activity in EMEA region as well as additional revenue from the acquisition of Patapsco in the third quarter of 2011.

Gross margin on the first nine months of Transition Networks’ sales increased to \$36,243,000 in 2011 from \$27,178,000 in 2010. Gross margin as a percentage of sales decreased to 46% in 2011, compared to 55% in the 2010 period, due to volume discounts on an upgrade project with the Fortune 500 company described above. Selling, general and administrative expenses increased 9% to \$17,246,000 in 2011 compared to \$15,772,000 in 2010 due to the increase in headcount and an increase in marketing as well as research and development expenses. Operating income increased to \$18,996,000 in 2011 compared to \$11,406,000 in 2010.

JDL Technologies, Inc.

JDL Technologies, Inc. sales increased 24% in the first nine months of 2011 to \$11,654,000 compared to \$9,384,000 in 2010.

JDL's revenues by customer group were as follows:

	JDL Revenue by Customer Group	
	2011	2010
Broward County FL schools	\$ 11,262,000	\$ 9,167,000
All other	392,000	217,000
	<u>\$ 11,654,000</u>	<u>\$ 9,384,000</u>

Revenues earned in Broward County FL increased \$2,095,000 or 23% in 2011. The increase was the result of Broward County receiving contract funding approval six months later than the usual announcement timeframe in the prior year, which resulted in lower revenue in the first half of 2010 – specifically the first quarter. As noted earlier, the Company had completed these contracts as of September 30, 2011.

JDL gross margin increased 19% to \$4,974,000 in the first nine months of 2011 compared to \$4,185,000 in the same period in 2010. Gross margin as a percentage of sales decreased to 43% in 2011 from 45% in 2010 as a result of lower gross margin during the third quarter related to decreases in purchase discounts. Selling, general and administrative expenses increased 44% in 2011 to \$1,523,000 compared to \$1,055,000 in 2010 due to headcount increases, specifically within the sales department, as JDL continues to expand its market focus. JDL reported operating income of \$3,451,000 in the first nine months of 2011 compared to \$3,130,000 in the same period of 2010.

Austin Taylor

Austin Taylor's revenues increased 11% to \$2,771,000 for the first nine months of 2011, compared to \$2,494,000 in 2010. This increase is due to continued sales penetration into the UK and Ireland distribution network and OEM market. Gross margin increased 19% to \$282,000 in 2011 from \$237,000 in 2010. Gross margin as a percentage of sales was 10% in 2011 compared to 9% in 2010. This increase was due to adjustments in both the OEM and distribution pricing. Austin Taylor reported an operating loss in 2011 of \$763,000 compared to \$617,000 in 2010.

Other

Income before income taxes increased to \$18,000,000 in 2011 compared to \$12,635,000 in 2010. The Company's effective income tax rate was 42% in 2011 as compared to 39% in 2010. This effective rate was higher than the standard rate of 35% due to state income taxes, foreign losses not deductible for U.S. income tax purposes, provisions for interest charges, goodwill impairment, and acquisition costs not deductible for income tax purposes.

Liquidity and Capital Resources

At September 30, 2011, the Company had approximately \$43,323,000 of cash equivalents and investments compared to \$43,075,000 of cash equivalents and investments at December 31, 2010. The Company had current assets of approximately \$91,422,000 and current liabilities of \$14,199,000 at September 30, 2011 compared to current assets of \$86,204,000 and current liabilities of \$12,669,000 at December 31, 2010.

Net cash provided by operating activities was \$8,252,000 in the first nine months of 2011 compared to \$4,977,000 in the same period in 2010. Significant working capital changes from December 31, 2010 to September 30, 2011 included an increase in accounts receivable of \$3,665,000 due to an overall increase in sales in the third quarter of 2011 as compared to the fourth quarter of 2010 and a \$1,358,000 decrease in accounts payable.

Net cash used in investing activities was \$1,018,000 in the first nine months in 2011 compared to cash used of \$8,097,000 in the same period in 2010. The Company acquired Patapsco Designs Limited during the third quarter of 2011 and paid \$3,271,000 in initial consideration, with an estimated \$1,760,000 to be paid out in deferred and contingent consideration.

Net cash used in financing activities was \$3,892,000 and \$3,776,000 in the first nine months of 2011 and 2010, respectively. Cash dividends paid in the first nine months of 2011 were \$3,796,000 (\$0.45 per common share) compared to \$3,599,000 (\$0.43 per common share) in the same period in 2010. Proceeds from common stock issuances, principally issued under the Company's Employee Stock Purchase Plan, totaled approximately \$178,000 in the first nine months of 2011 and \$100,000 in the same period in 2010. In the first nine months of 2011, the Company did not purchase any of its outstanding common shares. At September 30, 2011, 481,938 additional shares could be repurchased under outstanding Board authorizations.

The Company has a \$10,000,000 line of credit from U.S. Bank. Interest on borrowings on the credit line is at the LIBOR rate plus 1.5% (1.9% at September 30, 2011). There were no borrowings on the line of credit during the first nine months of 2011 or 2010. The prior credit agreement expired October 31. As noted within the notes to the financial statements, the Company entered into a new \$10,000,000 line of credit agreement effective October 28, 2011, expiring on October 31, 2013.

As part of the acquisition of the new Minnetonka headquarters building in July 2007, the Company assumed an outstanding mortgage of \$4,380,000. The mortgage is payable in monthly installments and carries an interest rate of 6.83%. The mortgage matures on March 1, 2016. Mortgage payments on principal totaled \$297,000 during the first nine months of 2011. The outstanding balance on the mortgage was \$2,105,000 at September 30, 2011.

In the opinion of management, based on the Company's current financial and operating position and projected future expenditures, sufficient funds are available to meet the Company's anticipated operating and capital expenditure needs.

Critical Accounting Policies

Our critical accounting policies, including the assumptions and judgments underlying them, are discussed in our 2010 Form 10-K in Note 1 Summary of Significant Accounting Policies included in our Consolidated Financial Statements. There were no significant changes to our critical accounting policies during the nine months ended September 30, 2011.

The Company's accounting policies have been consistently applied in all material respects and disclose such matters as allowance for doubtful accounts, sales returns, inventory valuation, warranty expense, income taxes, revenue recognition, asset and goodwill impairment recognition and foreign currency translation. On an ongoing basis, we evaluate our estimates based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the result of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. Management reviews these estimates and judgments on an ongoing basis.

Recently Issued Accounting Pronouncements

We do not believe there are any recently issued accounting standards that have not yet been adopted that will have a material impact on the Company's financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The Company has no freestanding or embedded derivatives. The Company's policy is to not use freestanding derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales.

The vast majority of our transactions are denominated in U.S. dollars; as such, fluctuations in foreign currency exchange rates have historically not been material to the Company. At September 30, 2011 our bank line of credit carried a variable interest rate based on the LIBOR plus 1.5%. The Company's investments are either money market type of investments that earn interest at prevailing market rates or certificates of deposits insured through the FDIC and as such do not have material risk exposure.

Based on the Company's operations, in the opinion of management, no material future losses or exposure exist relative to market risk.

Item 4. Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in the Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective.

There was no change in the Company's internal control over financial reporting that occurred during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable.

Item 1A. Risk Factors

The following Risk Factor supplements the Risk Factors contained in Item 1A of the Company Annual Report on Form 10-K for the year ended December 31, 2010:

The Company may experience fluctuations in quarterly results due to the timing and frequency of large orders.

From time to time, the Company receives large customer orders that result in variability in sales from operations and net income. During the nine months ended September 30, 2011, the Company had sales of \$118.4 million and net income of \$10.4 million compared with sales of \$89.9 million and net income of \$7.7 million in the comparable 2010 period. The increase in 2011 sales resulted primarily from \$32.8 million in revenue from the Company's Transition Networks business unit from a one-time large network upgrade project with a Fortune 500 company during the second and third quarter of 2011. This upgrade was substantially completed by September 30, 2011. The increase in revenue from this customer was partially offset by a decrease in sales to some of Transition Networks' traditional other customers. These declines were attributable, in part, to the continuing weakness in the U.S. housing market and to a slowdown in U.S. government purchasing resulting from the delays and uncertainty surrounding the U.S. government budgeting process.

Our future success will depend in part on our ability to successfully and profitably integrate our acquisitions with our existing operations.

On July 27, 2011, the Company acquired Patapsco Design Limited of the UK for approximately \$5.0 million. Patapsco will operate as part of our Transition Networks business unit. Our future profitability will depend on our ability to successfully and profitably integrate Patapsco and any future acquisitions and their products, services, technologies and personnel into our existing product lines and businesses.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3. Defaults Upon Senior Securities

Not Applicable.

Item 4. [Removed and Reserved]

Item 5. Other Information

New Credit Agreement

Effective October 28, 2011, Communications Systems, Inc., together with its subsidiaries JDL Technologies, Incorporated and Transition Networks, Inc. (collectively the "Company") entered into a new Credit Agreement (the "Credit Agreement") with Wells Fargo Bank, National Association (the "Bank"), as its primary credit facility. Under the terms of the Credit Agreement, the Company may access up to an aggregate principal amount of \$10.0 million through November 1, 2013. The credit facility also allows the issuance of standby letters of credit not to exceed \$10.0 million. The Company's obligation to repay advances under the credit facility is evidenced by a Revolving Line of Credit Note also dated October 28, 2011.

The Credit Agreement requires the Company to maintain the following financial covenants, using GAAP (except to the extent expressly modified in the Credit Agreement), with compliance determined as of each fiscal quarter end, determined on a rolling four-quarter basis, commencing with financial statements for the quarter ending December 31, 2011:

- (a) a minimum Current Ratio not less than 1.75 to 1.0;

- (b) a minimum Net Profit of \$3.0 million;
- (c) a minimum Tangible Net Worth of not less than \$60.0 million; and
- (d) no two consecutive quarterly losses.

The foregoing summary of the Credit Agreement and the Revolving Line of Credit Note are qualified in their entirety by reference to the full text of the agreements attached hereto as Exhibits 10.1 and 10.2 to this Form 10-Q and incorporated herein by reference.

Amendment of Stock Plans

At the Company's 2011 Annual Meeting of Shareholders, the Company's shareholders approved the Communications Systems, Inc. 2011 Executive Incentive Compensation Plan (the "2011 Plan"). In connection with the approval of the 2011 Plan, the Company advised its shareholders that it would amend the CSI 1992 Stock Plan and the CSI 1990 Stock Plan for Nonemployee Directors to provide that the Company would not grant any future awards under either of these two plans. At its August 11, 2011 meeting, the Company's Board of Directors amended these two plans to provide no new awards would be issued under them. All existing awards continue to be exercisable in accordance with their terms and the terms of their respective plans. Copies of the two plans, as amended as of August 11, 2011 are attached as Exhibits 10.3 and 10.4 to this Form 10-Q.

Item 6 Exhibits.

The following exhibits are included herein:

- 10.1 Credit Agreement dated as of October 28, 2011 between Communications Systems, Inc., JDL Technologies, Incorporated, Transition Networks, Inc. and Wells Fargo Bank, National Association.
- 10.2 Revolving Line of Credit Note, dated as October 28, 2011, from Communications Systems, Inc., JDL Technologies, Incorporated, Transition Networks, Inc. to Wells Fargo Bank, National Association.
- 10.3 Communications Systems, Inc. 1992 Stock Plan, as amended August 11, 2011.
- 10.4 Communications Systems, Inc. 1990 Stock Option Plan for Nonemployee Directors, as amended August 11, 2011.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act).
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rules 13a-14 and 15d-14 of the Exchange Act).
- 32. Certifications pursuant Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350).
- 99.1 Press Release dated November 9, 2011 announcing 2011 Third Quarter Results.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

Date: November 10, 2011

Communications Systems, Inc.
By /s/ William G. Schultz
William G. Schultz
President and Chief Executive Officer

Date: November 10, 2011

/s/ David T. McGraw
David T. McGraw
Chief Financial Officer

CREDIT AGREEMENT

among

COMMUNICATIONS SYSTEMS, INC.,

JDL TECHNOLOGIES, INCORPORATED and TRANSITION NETWORKS, INC.,

as Borrowers,

and

WELLS FARGO BANK, NATIONAL ASSOCIATION

as Bank

Closing Date: October 28, 2011



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CREDIT AGREEMENT

THIS CREDIT AGREEMENT (this "**Agreement**") is entered into as of October 28, 2011 by and among COMMUNICATIONS SYSTEMS, INC., a Minnesota corporation ("**Communications Systems**"), JDL TECHNOLOGIES, INCORPORATED, a Minnesota corporation ("**JDL**"), TRANSITION NETWORKS, INC., a Minnesota corporation ("**Transition Networks**"; together with Communications Systems and JDL, "**Borrowers**" and each a "**Borrower**"), and WELLS FARGO BANK, NATIONAL ASSOCIATION, a national banking association ("**Bank**").

RECITALS

Borrowers have requested that Bank extend credit to Borrowers as described below, and Bank has agreed to provide such credit to Borrowers on the terms and conditions contained herein.

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Bank and Borrowers hereby agree as follows:

ARTICLE I CREDIT TERMS

Section 1.1 **Line of Credit.**

(a) Line of Credit. Subject to the terms and conditions of this Agreement, Bank hereby agrees to make advances to Borrowers from time to time up to and including November 1, 2013, not to exceed at any time the aggregate principal amount of Ten Million Dollars (\$10,000,000) (the "**Line of Credit**"), the proceeds of which shall be used for working capital and other general corporate purposes. Borrower's obligation to repay advances under the Line of Credit shall be evidenced by a promissory note of even date herewith (as amended, restated, supplemented, extended, replaced, renewed or otherwise modified from time to time, the "**Revolving Note**"), all terms of which are incorporated herein by this reference. Each Borrower jointly and severally promises to pay the debts, liabilities and obligations arising under or in connection with this Agreement, the Revolving Note and the other Loan Documents (including principal, interest, fees, costs, and expenses) in full on the Maturity Date (as defined in the Revolving Note).

(b) Letter of Credit Subfeature. As a subfeature under the Line of Credit, Bank agrees from time to time during the term thereof to issue or cause an affiliate to issue standby or commercial letters of credit for the account of a Borrower (each, a "**Letter of Credit**" and collectively, "**Letters of Credit**"); provided however, that the aggregate undrawn amount of all outstanding Letters of Credit shall not at any time exceed Ten Million Dollars (\$10,000,000); and provided, further, that no Letter of Credit shall be issued hereunder if, after giving effect to the issuance of such Letter of Credit, the Aggregate Outstanding Amount would exceed the amount of the Line of Credit. The form and substance of each Letter of Credit shall be subject to approval by Bank, in its sole discretion. Each Letter of Credit shall be issued for a term not to exceed one (1) year, as designated by Borrower; provided however, that no Letter of Credit shall have an expiration date subsequent to the maturity date of the Line of Credit. The undrawn amount of all issued and outstanding Letters of Credit shall be reserved under the Line of Credit and shall not be available for borrowings thereunder. Each Letter of Credit shall be subject to the additional terms and conditions of such letter of credit agreements, applications and any related documents required by Bank in connection with the issuance thereof. Each drawing paid under a Letter of Credit shall be deemed an advance under the Line of Credit and shall be repaid by

Borrowers in accordance with the terms and conditions of this Agreement applicable to such advances; provided however, that if advances under the Line of Credit are not available, for any reason, at the time any drawing is paid, then Borrowers shall immediately pay to Bank the full amount drawn, together with interest thereon from the date such drawing is paid to the date such amount is fully repaid by Borrowers, at the rate of interest applicable to advances under the Line of Credit. In such event Borrowers agree that Bank, in its sole discretion, may debit any account maintained by any Borrower with Bank for the amount of any such drawing. As used herein, “**Aggregate Outstanding Amount**” means the sum of (i) the aggregate principal amount of all outstanding advances made by Bank under the foregoing clause (a) and (ii) the aggregate remaining available amount of all issued and outstanding Letters of Credit and Borrowers’ obligation to pay amounts drawn under Letters of Credit which have not yet been reimbursed with proceeds of an advance or otherwise.

(c) **Borrowing and Repayment.** Borrower may from time to time during the term of the Line of Credit borrow, partially or wholly repay its outstanding borrowings, and reborrow, subject to all of the limitations, terms and conditions contained herein or in the Revolving Note; provided however, that the total outstanding borrowings under the Line of Credit shall not at any time exceed the maximum principal amount available thereunder, as set forth above.

Section 1.2 **Interest/Fees.**

(a) **Interest.** The outstanding principal balance of advances under the Line of Credit, and the amount of each drawing paid under any Letter of Credit, shall bear interest at the rate of interest set forth in the Revolving Note.

(b) **Computation and Payment.** Interest shall be computed on the basis of a 360-day year, actual days elapsed. Interest shall be payable at the times and place set forth in the Revolving Note or other instrument or document required hereby.

(c) **Unused Fee.** Borrowers shall pay to Bank a fee equal to 0.125% per annum, computed on the basis of a 360-day year, actual days elapsed, on the average daily unused amount of the Line of Credit, which fee shall be calculated on a quarterly basis and shall be due and payable by Borrowers on the last business day of each quarter. Any portion of the unused fee under this clause (c) remaining unpaid on the Maturity Date shall be due and payable on such date.

(d) **Letter of Credit Fees.** Borrowers shall pay to Bank (i) fees upon the issuance or renewal of each Letter of Credit equal to the greater of (A) \$500 and (B) one and one-tenth of one percent (1.10%) (computed on the basis of a 360-day year, actual days elapsed) of the face amount of such Letter of Credit, and (ii) fees upon the payment or negotiation of each drawing under each Letter of Credit and upon the occurrence of any other activity with respect to any Letter of Credit (including, without limitation, the transfer, amendment or cancellation of any Letter of Credit) determined in accordance with Bank’s standard fees and charges then in effect for such activity.

Section 1.3 **Collection of Payments.** Borrowers authorize Bank to collect all principal, interest and fees and other amounts due under or in connection with this Agreement, the Revolving Note or the other Loan Documents by charging Communications System’s deposit account number 4124303454 with Bank, or any other deposit account maintained by any Borrower with Bank, for the full amount thereof. Should there be insufficient funds in any such deposit account to pay all such sums when due, the full amount of such deficiency shall be immediately due and payable by Borrowers.

Section 1.4 **Collateral.** As security for all indebtedness and other debts, liabilities and obligations of Borrowers to Bank, each Borrower hereby grants to Bank security interests of first priority (except as otherwise permitted by this Agreement) in all of such Borrower's property. The foregoing shall be evidenced by and subject to the terms of such additional security agreements, financing statements, deeds or mortgages, and other documents as Bank shall reasonably require, all in form and substance satisfactory to Bank. Borrowers shall pay to Bank immediately upon demand the full amount of all charges, costs and expenses (to include fees paid to third parties and all allocated costs of Bank personnel), expended or incurred by Bank in connection with any of the foregoing security interest or agreements and documents, including without limitation, filing and recording fees and costs of appraisals, audits and title insurance.

Section 1.5 **Additional Definition.** As used herein, "**Subsidiary**" means any corporation, partnership, limited liability company or other entity of which more than 50% of the outstanding capital stock having general voting power under ordinary circumstances to elect a majority of the governing board of such entity (irrespective of whether or not at the time stock or membership interests of any other class or classes shall have or might have voting power by reason of the happening of any contingency) is at the time directly or indirectly owned by any Borrower. Unless otherwise specified, "Subsidiary" means a Subsidiary of a Borrower.

ARTICLE II REPRESENTATIONS AND WARRANTIES

Borrowers make the following representations and warranties to Bank, which representations and warranties shall survive the execution of this Agreement and shall continue in full force and effect until the full and final payment, and satisfaction and discharge, of all obligations of Borrowers to Bank subject to this Agreement.

Section 2.1 **Legal Status.** Communications Systems, JDL and Transition Networks are each a corporation, duly organized and existing and in good standing under the laws of Minnesota, and each is qualified or licensed to do business (and is in good standing as a foreign corporation, if applicable) in all jurisdictions in which such qualification or licensing is required or in which the failure to so qualify or to be so licensed could have a material adverse effect on Borrowers.

Section 2.2 **Authorization and Validity.** This Agreement, the Revolving Note and each contract, instrument and other document required hereby or at any time hereafter delivered to Bank in connection herewith (collectively, the "**Loan Documents**") have been duly authorized, and upon their execution and delivery in accordance with the provisions hereof will constitute legal, valid and binding agreements and obligations of Borrowers or the party which executes the same, enforceable in accordance with their respective terms.

Section 2.3 **No Violation.** The execution, delivery and performance by Borrowers of each of the Loan Documents do not and will not violate any provision of any law or regulation, or contravene any provision of the articles of incorporation or bylaws of any Borrower, or result in any breach of or default under any contract, obligation, indenture or other instrument to which any Borrower is a party or by which any Borrower may be bound, or require any authorization, consent or approval which has not been obtained prior to the date hereof, or require any authorization, consent or approval by, or registration, declaration or filing (other than filing of financing statements and recording of mortgages as contemplated hereunder) with, or notice to, any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or any third party, except such authorization, consent, approval, registration, declaration, filing or notice as has been obtained, accomplished or given prior to

the date hereof, or violate any provision of any law, rule or regulation (including but not limited to Regulations T, U or X of the Board of Governors of the Federal Reserve System) or of any order, writ, injunction or decree presently in effect having applicability to any Borrower or of the articles of incorporation or bylaws of any Borrower.

Section 2.4 Litigation. Except as set forth in Schedule 2.4, there are no pending, or to the best of any Borrower's knowledge threatened, actions, claims, investigations, suits or proceedings by or before any governmental authority, arbitrator, court or administrative agency which could have a material adverse effect on the financial condition or operation of any Borrower other than those disclosed by Borrowers to Bank in writing prior to the date hereof.

Section 2.5 Correctness of Financial Statement. The annual financial statements of Borrowers dated December 31, 2010, and all interim financial statements delivered to Bank since said date, true copies of which have been delivered by Borrowers to Bank prior to the date hereof, (a) are complete and correct and present fairly the financial condition of Borrower, (b) disclose all liabilities of Borrowers that are required to be reflected or reserved against under generally accepted accounting principles consistently applied ("**GAAP**"), whether liquidated or unliquidated, fixed or contingent, and (c) have been prepared in accordance with GAAP. Since the dates of such financial statements there has been no material adverse change in the financial condition of Borrowers, nor has any Borrower mortgaged, pledged, granted a security interest in or otherwise encumbered any of its assets or properties except in favor of Bank or as otherwise permitted by Bank in writing.

Section 2.6 Income Tax Returns. Borrowers have no knowledge of any pending assessments or adjustments of its income tax payable with respect to any year, and each Borrower has paid or caused to be paid to the proper authorities when due all federal, state, foreign and local taxes required to be withheld by it. Each Borrower has filed all federal, state and local tax returns which are required to be filed, and each Borrower has paid or caused to be paid to the respective taxing authorities all taxes as shown on said returns or on any assessment received by it to the extent such taxes have become due, except for any such tax, assessment, charge or claim whose amount, applicability or validity is being contested by such Borrower in good faith and by proper proceedings and for which such Borrower shall have set aside adequate reserves in accordance with GAAP.

Section 2.7 No Subordination. There is no agreement, indenture, contract or instrument to which any Borrower is a party or by which any Borrower may be bound that requires the subordination in right of payment of any of such Borrower's obligations subject to this Agreement to any other obligation of such Borrower.

Section 2.8 Permits, Franchises. Each Borrower possesses, and will hereafter possess, all permits, consents, approvals, franchises and licenses required and rights to all trademarks, trade names, patents, and fictitious names, if any, necessary to enable it to conduct the business in which it is now engaged in compliance with applicable law.

Section 2.9 ERISA. Each Borrower is in compliance in all material respects with all applicable provisions of the Employee Retirement Income Security Act of 1974, as amended or recodified from time to time ("**ERISA**"); no Borrower has violated any provision of any defined employee pension benefit plan (as defined in ERISA) maintained or contributed to by such Borrower (each, a "**Plan**"); no Reportable Event as defined in ERISA has occurred and is continuing with respect to any Plan initiated by any Borrower; each Borrower has met its minimum funding requirements under ERISA with respect to each Plan; and each Plan will be able to fulfill its benefit obligations as they come due in accordance with the Plan documents and under GAAP.

Section 2.10 **Other Obligations.** No Borrower is in default on any obligation for borrowed money, any purchase money obligation or any other material lease, commitment, contract, instrument or obligation.

Section 2.11 **Environmental Matters.** Except as set forth in Schedule 2.11, to the best of each Borrower's knowledge, such Borrower is in compliance in all material respects with all applicable federal or state environmental, hazardous waste, health and safety statutes, and any rules or regulations adopted pursuant thereto, which govern or affect any of any Borrower's operations and/or properties, including without limitation, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Superfund Amendments and Reauthorization Act of 1986, the Federal Resource Conservation and Recovery Act of 1976, and the Federal Toxic Substances Control Act, as any of the same may be amended, modified or supplemented from time to time. To the best of each Borrower's knowledge, none of the operations of such Borrower is the subject of any federal or state investigation evaluating whether any remedial action involving a material expenditure is needed to respond to a release of any toxic or hazardous waste or substance into the environment. No Borrower has any material contingent liability in connection with any release of any toxic or hazardous waste or substance into the environment.

Section 2.12 **Real Property.** Set forth and described in Schedule 2.12 is a correct and complete list of all interests (including, but not limited to, all fee simple and leasehold interests) of each Borrower in any real property or fixtures, wherever located.

Section 2.13 **Adverse Change.** There has been no material adverse change in the business, properties or condition (financial or otherwise) of Borrowers since the date of the last financial statement referred to in Section 2.5.

Section 2.14 **Intellectual Property Rights.** Schedule 2.14 is a complete list of all intellectual property or other proprietary rights, including all rights arising in connection with copyrights, patents, service marks, trade dress, trade secrets, trademarks, trade names or mask works, applications, and material unregistered copyrights and service marks (collectively, the "**Intellectual Property**") owned by each Borrower, including the application, registration or patent number of each item. Borrowers own the Intellectual Property free and clear of all restrictions (including covenants not to sue a third person and entity), court orders, injunctions, decrees, writs or security interests, liens, charges or other encumbrances (other than those specifically permitted by this Agreement), whether by written agreement or otherwise, (i) no person or entity other than a Borrower owns or has been granted any right in the Intellectual Property, (ii) all Intellectual Property is valid, subsisting and enforceable, and (iii) each Borrower has taken all commercially reasonable action necessary to maintain, protect and enforce the Intellectual Property owned by it.

ARTICLE III CONDITIONS

Section 3.1 **Conditions of Initial Extension of Credit.** The obligation of Bank to extend any credit contemplated by this Agreement is subject to the fulfillment to Bank's satisfaction of all of the following conditions:

- (a) Approval of Bank Counsel. All legal matters incidental to the extension of credit by Bank shall be satisfactory to Bank's counsel.
- (b) Documentation. Bank shall have received, in form and substance satisfactory to Bank, each of the following, duly executed by the parties thereto:

(i) This Agreement.

(ii) The Revolving Note.

(iii) The Security Agreement between Borrowers and Bank.

(iv) The Standby Letter of Credit Agreements.

(v) The Commercial Letter of Credit Agreements.

(vi) Financing statements with respect to each Borrower to be filed in each jurisdiction which, in the opinion of Bank, is reasonably necessary to perfect the security interests and liens created by the Security Agreement, to the extent such security interests and liens can be perfected by filing.

(vii) Current searches of appropriate filing offices in the jurisdiction in which the Borrowers are organized, has an office or otherwise conducts business (including but not limited to patent and trademark offices, secretaries of state and county recorders) showing that no state or federal tax liens have been filed and remain in effect against Borrower, and that no financing statements or other notifications or filings have been filed and remain in effect against Borrower, other than those for which Bank has received an appropriate release, termination or satisfaction or those permitted in accordance with this Agreement.

(viii) Certificate of the secretary or other appropriate officer of each Borrower (A) certifying that the execution, delivery and performance of this Agreement, the Revolving Note and other documents contemplated hereunder to which such Borrower is a party have been duly approved by all necessary action of the board of directors of such Borrower, and attaching true and correct copies of the applicable resolutions granting such approval, and (B) certifying that attached to such certificate are true and correct copies of such Borrower's articles of incorporation and bylaws, together with such copies, together with a certification of the names of the officers of such Borrower that are authorized to sign this Agreement, the Revolving Note and other documents contemplated hereunder, together with the true signatures of such officers. Bank may conclusively rely on such certificate until Bank receives a further certificate of the secretary or assistant secretary of such Borrower canceling or amending the prior certificate and submitting the signatures of the officers named in such further certificate.

(ix) A certificate of good standing for each Borrower from the Secretary of State (or the appropriate official) of the state of formation of such Borrower, dated not more than 30 days prior to the Closing Date.

(x) Such other documents as Bank may require under any other section of this Agreement.

(c) Financial Condition. There shall have been no material adverse change, as determined by Bank, in the financial condition or business of any Borrower, nor any material decline, as determined by Bank, in the market value of any collateral required hereunder or a substantial or material portion of the assets of any Borrower.

(d) Insurance. Borrowers shall have delivered to Bank evidence of insurance coverage on all of each Borrower's property, in form, substance, amounts, covering risks and issued by companies satisfactory to Bank, and where required by Bank, with lender's loss payable and additional insured endorsements in favor of Bank.

(e) Costs and Expenses. Payment of all fees and expenses then due and payable pursuant to this Agreement.

Section 3.2 **Conditions of Each Extension of Credit**. The obligation of Bank to make each extension of credit requested by Borrowers hereunder shall be subject to the fulfillment to Bank's satisfaction of each of the following conditions:

(a) Compliance. The representations and warranties contained herein and in each of the other Loan Documents shall be true on and as of the date of the signing of this Agreement and on the date of each extension of credit by Bank pursuant hereto, with the same effect as though such representations and warranties had been made on and as of each such date, and on each such date, no Event of Default as defined herein, and no condition, event or act which with the giving of notice or the passage of time or both would constitute such an Event of Default, shall have occurred and be continuing or shall exist.

(b) Documentation. Bank shall have received all additional documents which may be required in connection with such extension of credit.

ARTICLE IV AFFIRMATIVE COVENANTS

Each Borrower covenants that so long as Bank remains committed to extend credit to Borrowers pursuant hereto, or any liabilities (whether direct or contingent, liquidated or unliquidated) of Borrowers to Bank under any of the Loan Documents remain outstanding, and until payment in full of all obligations of Borrowers subject hereto, Borrowers shall, and shall cause each Subsidiary to, unless Bank otherwise consents in writing:

Section 4.1 **Punctual Payments**. Punctually pay all principal, interest, fees or other liabilities due under any of the Loan Documents at the times and place and in the manner specified therein, and immediately upon demand by Bank, the amount by which the outstanding principal balance of any credit subject hereto at any time exceeds any limitation on borrowings applicable thereto.

Section 4.2 **Accounting Records**. Maintain adequate books and records in accordance with GAAP consistently applied, and permit any representative of Bank, upon advance notice and at any reasonable time, to inspect, audit and examine such books and records, to make copies of the same, and to inspect the properties of each Borrower.

Section 4.3 **Financial Statements**. Provide to Bank all of the following, in form and detail satisfactory to Bank:

(a) as soon as available, and in any event not later than 120 days after and as of the end of each fiscal year, audited annual financial statements of Borrowers and an unqualified opinion, prepared by independent certified public accountants acceptable to Bank, to include balance sheets as of the end of such fiscal year and the related statements of income, retained earnings and cash flows of the Borrowers for the fiscal year then ended, prepared on a

consolidating and consolidated basis, all in reasonable detail and prepared in accordance with GAAP;

(b) not later than 45 days after and as of the end of each fiscal quarter, financial statements of Borrowers, prepared by Borrowers, including an unaudited internal balance sheets and statements of income, cash flow and retained earnings of Borrowers as at the end of such quarter and for the year-to-date period then ended, prepared on a consolidating and consolidated basis, in reasonable detail, all prepared in accordance with GAAP, subject to year-end audit adjustments and the absence of footnotes;

(c) not later than 45 days after and as of the end of each fiscal quarter, in form and substance acceptable to Bank, a compliance certificate;

(d) contemporaneously with each annual and quarterly financial statement of Borrowers required hereby, a certificate of the president or chief financial officer of each Borrower that said financial statements are accurate and that there exists no Event of Default nor any condition, act or event which with the giving of notice or the passage of time or both would constitute an Event of Default or, if such officer has knowledge of the occurrence of any Event of Default or any condition, act or event which with the giving of notice or the passage of time or both would constitute an Event of Default, stating in reasonable detail the facts with respect thereto;

(e) not later than 120 days after the commencement of each fiscal year, the projected balance sheets, income statements, capital expenditures budget, and cash flow statements of Borrowers for each month of such year, each in reasonable detail, representing the good faith projections of Borrowers for each such month, and certified by each Borrower's president or chief financial officer as being the most accurate projections available, together with such supporting schedules and information as Bank from time to time may reasonably request; and

(f) from time to time such other information as Bank may reasonably request.

Section 4.4 Compliance. Preserve and maintain all licenses, permits, governmental approvals, rights, privileges and franchises necessary for the conduct of its business; and comply with the provisions of all documents pursuant to which each Borrower is organized and/or which govern such Borrower's continued existence and with the requirements of all laws, rules, regulations and orders of any governmental authority applicable to any Borrower and/or its business.

Section 4.5 Insurance. Maintain and keep in force, for each business in which each Borrower is engaged, insurance of the types and in amounts customarily carried in similar lines of business, including but not limited to fire, extended coverage, public liability, flood, property damage and workers' compensation, with all such insurance carried with companies and in amounts satisfactory to Bank and including such lender's loss payable and additional insured endorsements as Bank may request, and deliver to Bank from time to time at Bank's request schedules setting forth all insurance then in effect.

Section 4.6 Facilities. Keep all properties useful or necessary to each Borrower's business in good repair and condition, and from time to time make necessary repairs, renewals and replacements thereto so that such properties shall be fully and efficiently preserved and maintained. At any time upon Bank's request, obtain a consent and waiver agreement, in form and substance acceptable to Bank, signed by each landlord with respect to any Borrower's leased locations as shown on Schedule

2.12, acknowledging Bank's prior security interest in all personal property located on such leased site and allowing Bank to enter upon such leased site to remove such personal property at any time.

Section 4.7 **Taxes and Other Liabilities.** Pay and discharge when due any and all indebtedness, obligations, assessments and taxes, both real or personal, including without limitation federal and state income taxes and state and local property taxes and assessments, except (a) such as a Borrower may in good faith contest or as to which a bona fide dispute may arise, and (b) for which such Borrower has made provision, to Bank's satisfaction, for eventual payment thereof in the event such Borrower is obligated to make such payment.

Section 4.8 **Litigation.** Promptly give notice in writing to Bank of any litigation pending or threatened against any Borrower with a claim in excess of \$250,000.

Section 4.9 **Financial Condition.** Maintain Borrowers' financial condition as follows using GAAP (except to the extent modified by the definitions herein), with compliance determined as of each fiscal quarter end, determined on a rolling four-quarter basis, commencing with financial statements for the quarter ending December 31, 2011:

- (a) a minimum Current Ratio not less than 1.75 to 1.0;
- (b) a minimum Net Profit of \$3,000,000;
- (c) a minimum Tangible Net Worth of not less than \$60,000,000; and
- (d) no two consecutive quarterly losses.

As used herein:

(v) "**Current Ratio**" means, with respect to the applicable computation period, the ratio of (i) current assets owned by such entity to (ii) current liabilities of such entity, plus the sum of all outstanding working capital borrowings under the Line of Credit and Letters of Credit issued under this Agreement;

(x) "**Net Profit**" means net profit of an entity before tax;

(y) "**Tangible Net Worth**" means the sum of (i) an entity's total net worth less (ii) any intangible assets owned by such entity, plus the sum of all Subordinated Debt; and

(z) "**Subordinated Debt**" means debt of a person or entity that is subordinated to the payment of all debts, liabilities and obligations of Borrowers arising under or in connection with this Agreement and any other Loan Documents and all rights and remedies granted to Bank under or in connection with this Agreement and any other Loan Documents pursuant to a subordination agreement in form and substance acceptable to Bank in its sole discretion, executed and delivered by each holder of such subordinated debt in favor of Bank.

Section 4.10 **Notice to Bank.** Promptly (but in no event more than five business (5) days after the occurrence of each such event or matter) give written notice to Bank in reasonable detail of: (a) the occurrence of any Event of Default, or any condition, event or act which with the giving of notice or the passage of time or both would constitute an Event of Default; (b) any change in the name or the organizational structure of any Borrower; (c) the occurrence and nature of any Reportable Event or Prohibited Transaction, each as defined in ERISA, or any funding deficiency with respect to any Plan; or

(d) any termination or cancellation of any insurance policy which any Borrower is required to maintain, or any uninsured or partially uninsured loss through liability or property damage, or through fire, theft or any other cause affecting any Borrower's property in excess of an aggregate of \$250,000.

Section 4.11 **UCC Terminations.** No later than thirty days following the date of this Agreement, Borrowers will deliver to Bank a filed UCC-3 termination statement with respect to each of the following UCC-1 financing statements: (a) UCC-1 Financing Statement filed as filing number 201020348066 on May 24, 2010 with the Minnesota Secretary of State, naming Communications Systems as debtor and US Bancorp as secured party; and (b) UCC-1 Financing Statement filed as filing number 200916106668 on May 15, 2009 with the Minnesota Secretary of State, naming JDL as debtor and GE Commercial Distribution Finance Corporation as secured party.

ARTICLE V NEGATIVE COVENANTS

Borrowers further covenant that so long as Bank remains committed to extend credit to Borrower pursuant hereto, or any liabilities (whether direct or contingent, liquidated or unliquidated) of Borrowers to Bank under any of the Loan Documents remain outstanding, and until payment in full of all obligations of Borrowers subject hereto, Borrowers will not, and will not permit any Subsidiary to, without Bank's prior written consent:

Section 5.1 **Use of Funds.** Use any of the proceeds of any credit extended hereunder except for the purposes stated in Article I hereof.

Section 5.2 **Other Indebtedness.** Create, incur, assume or permit to exist any indebtedness or liabilities resulting from borrowings, loans or advances, whether secured or unsecured, matured or unmatured, liquidated or unliquidated, joint or several, except (a) the liabilities of Borrowers to Bank; (b) any other debts, liabilities or obligations of Borrowers existing as of the date of this Agreement and set forth in Schedule 5.2 hereto; (c) debts of Borrowers secured by purchase money liens not to exceed \$500,000 in the aggregate at any time outstanding; (d) any indebtedness arising from any Permitted Acquisition. As used herein, "**Permitted Acquisition**" means an acquisition by a Borrower of (x) assets constituting a business, division or product line of any entity not already a Subsidiary, or (y) the capital stock or equity of any such entity (including by way of merger) as a result of which stock acquisition such entity shall become a Subsidiary of such Borrower or shall be merged with and into a Subsidiary of such Borrower, provided that (in each case), the business activities of the acquired entity are substantially similar to the business activities conducted by any Borrower or its Subsidiaries at the time of the transaction or a reasonable extension thereof and, in the case of any consolidation or merger, a Borrower or an existing Subsidiary shall be the continuing or surviving corporation (provided, however, that under no circumstances may a Borrower merge into or consolidate with any Subsidiary).

Section 5.3 **Merger, Consolidation, Transfer of Assets.** Merge into or consolidate with any other entity; make any substantial change in the nature of any Borrower's business as conducted as of the date hereof; sell, lease, transfer or otherwise dispose of all or a substantial or material portion of Borrower's assets except in the ordinary course of its business.

Section 5.4 **Guaranties.** Guarantee or become liable in any way as surety, endorser (other than as endorser of negotiable instruments for deposit or collection in the ordinary course of business), accommodation endorser or otherwise for, or pledge or hypothecate any assets of any Borrower as security for, any liabilities or obligations of any other person or entity, except any of the foregoing in favor of Bank.

Section 5.5 **Loans, Advances, Investments.** Make any loans or advances in excess of \$250,000 in the aggregate per fiscal year to any person or entity or make, purchase, hold or permit to exist any other investments of any kind, except any of the foregoing existing as of the date of this Agreement and set forth on Schedule 5.6 hereto.

Section 5.6 **Pledge of Assets.** Mortgage, pledge, grant or permit to exist a security interest in, or lien upon, all or any portion of its assets now owned or hereafter acquired, except (a) any of the foregoing in favor of Bank or (b) which is existing as of the date of this Agreement and set forth on Schedule 5.7 hereto or (c) which constitute purchase money liens securing indebtedness permitted under Section 5.2 hereof, provided that such purchase money liens do not extend to or cover any property of a Borrower or a Subsidiary other than the property then being acquired and the aggregate principal amount of the indebtedness secured by such lien does not exceed the cost of the property so acquired in connection therewith.

ARTICLE VI EVENTS OF DEFAULT

Section 6.1 **Event of Default.** The occurrence of any of the following shall constitute an “**Event of Default**” under this Agreement:

(a) Any Borrower shall fail to pay when due any principal, interest, fees or other amounts payable under any of the Loan Documents.

(b) Any financial statement or certificate furnished to Bank in connection with, or any representation or warranty made by any Borrower or any other party under this Agreement or any other Loan Document shall prove to be incorrect, false or misleading in any material respect when furnished or made.

(c) Any default in the performance of or compliance with any obligation, agreement or other provision contained herein or in any other Loan Document (other than those specifically described as an “**Event of Default**” in this Section 6.1), and with respect to any such default that by its nature can be cured, such default shall continue for a period of thirty (30) days from its occurrence.

(d) Any default in the payment or performance of any obligation, or any defined event of default, under the terms of any contract, instrument or document (other than any of the Loan Documents) pursuant to which any Borrower, any guarantor hereunder or any general partner or joint venturer in any Borrower if a partnership or joint venture (with each such guarantor, general partner and/or joint venturer referred to herein as a “**Third Party Obligor**”) has incurred any debt or other liability to any person or entity, including Bank, and with respect to any such default that by its nature can be cured, such default shall continue for a period of thirty (30) days from its occurrence; provided, however, that any default which causes or results in the acceleration of any debt or other liability shall not be considered a default that by its nature can be cured, and shall result in an immediate Event of Default hereunder.

(e) Any Borrower or any Third Party Obligor shall become insolvent, or shall suffer or consent to or apply for the appointment of a receiver, trustee, custodian or liquidator of itself or any of its property, or shall generally fail to pay its debts as they become due, or shall make a general assignment for the benefit of creditors; any Borrower or any Third Party Obligor shall file a voluntary petition in bankruptcy, or seeking reorganization, in order to effect a plan or other arrangement with creditors or any other relief under the Bankruptcy Reform Act, Title 11 of the

United States Code, as amended or recodified from time to time (“**Bankruptcy Code**”), or under any state or federal law granting relief to debtors, whether now or hereafter in effect; or any Borrower or any Third Party Obligor shall file an answer admitting the jurisdiction of the court and the material allegations of any involuntary petition; or any Borrower or any Third Party Obligor shall be adjudicated a bankrupt, or an order for relief shall be entered against any Borrower or any Third Party Obligor by any court of competent jurisdiction under the Bankruptcy Code or any other applicable state or federal law relating to bankruptcy, reorganization or other relief for debtors.

(f) The filing of a notice of judgment lien against any Borrower or any Third Party Obligor; or the recording of any abstract of judgment against any Borrower or any Third Party Obligor in any county in which such Borrower or such Third Party Obligor has an interest in real property; or the service of a notice of levy and/or of a writ of attachment or execution, or other like process, against the assets of any Borrower or any Third Party Obligor; or the entry of a judgment against any Borrower or any Third Party Obligor; or any involuntary petition or proceeding pursuant to the Bankruptcy Code or any other applicable state or federal law relating to bankruptcy, reorganization or other relief for debtors is filed or commenced against any Borrower or any Third Party Obligor.

(g) There shall exist or occur any event or condition that Bank in good faith believes likely to materially impair, or is substantially likely to materially impair, the prospect of payment or performance by any Borrower, any Third Party Obligor, or the general partner of either if such entity is a partnership, of its obligations under any of the Loan Documents.

(h) The dissolution or liquidation of any Borrower or any Third Party Obligor if a corporation, partnership, joint venture or other type of entity; or any Borrower or any such Third Party Obligor, or any of its directors, stockholders or members, shall take action seeking to effect the dissolution or liquidation of such Borrower or such Third Party Obligor.

Section 6.2 Remedies. Upon the occurrence of any Event of Default, Bank may exercise any or all of the following rights and remedies: (a) all indebtedness of Borrowers under each of the Loan Documents, any term thereof to the contrary notwithstanding, may at Bank’s option and without notice become immediately due and payable without presentment, demand, protest or notice of dishonor, all of which are hereby expressly waived by each Borrower; (b) the obligation, if any, of Bank to extend any further credit under any of the Loan Documents may immediately cease and terminate; (c) Bank may have all rights, powers and remedies available under each of the Loan Documents, or accorded by law, including without limitation the right to resort to any or all security for any credit subject hereto and to exercise any or all of the rights of a beneficiary or secured party pursuant to applicable law; and (d) Bank may apply for the appointment of, or taking possession by, a trustee, receiver, liquidator or other similar official of any Borrower to hold or liquidate all or any substantial part of the properties or assets of such Borrower. Borrowers hereby consent to such appointment and agrees to execute and deliver any and all documents requested by Bank relating to the appointment of such trustee, receiver, liquidator or other similar official (whether by joining in a petition for the appointment of such an official, by entering no contest to a petition for the appointment of such an official, or otherwise, as appropriate under applicable law). All rights, powers and remedies of Bank may be exercised at any time by Bank and from time to time after the occurrence of an Event of Default, are cumulative and not exclusive, and shall be in addition to any other rights, powers or remedies provided by law or equity.

Section 6.3 Right of Setoff. If an Event of Default shall have occurred, Bank and each of its Affiliates is hereby authorized at any time and from time to time, to the fullest extent permitted by applicable law, to set off and apply any and all deposits (general or special, time or demand, provisional

or final, in whatever currency) at any time held and other obligations (in whatever currency) at any time owing by Bank or any such affiliate to or for the credit or the account of Borrowers against any and all of the obligations of Borrowers now or hereafter existing under this Agreement or any other Loan Document to Bank or any such affiliate, irrespective of whether or not Bank shall have made any demand under this Agreement or any other Loan Document and although such obligations of Borrowers may be contingent or unmatured or are owed to a branch or office of Bank different from the branch or office holding such deposit or obligated on such indebtedness. The rights of each Lender Party and its affiliates under this Section are in addition to other rights and remedies (including other rights of setoff) that Bank or its affiliates may have. Bank will notify Borrowers promptly after any such setoff and application; provided, however, that the failure to give such notice shall not affect the validity of such setoff and application.

ARTICLE VII MISCELLANEOUS

Section 7.1 **No Waiver.** No delay, failure or discontinuance of Bank in exercising any right, power or remedy under any of the Loan Documents shall affect or operate as a waiver of such right, power or remedy; nor shall any single or partial exercise of any such right, power or remedy preclude, waive or otherwise affect any other or further exercise thereof or the exercise of any other right, power or remedy. Any waiver, permit, consent or approval of any kind by Bank of any breach of or default under any of the Loan Documents must be in writing and shall be effective only to the extent set forth in such writing.

Section 7.2 **Notices.** All notices, requests and demands which any party is required or may desire to give to any other party under any provision of this Agreement must be in writing delivered to each party at the following address:

BORROWERS:

Communications Systems, Inc.
10900 Red Circle Drive
Minnetonka, MN 55343

BANK:

Wells Fargo Bank, National Association
MAC N9307-230
7900 Xerxes Avenue S., Suite 2300
Bloomington, MN 55431

or to such other address as any party may designate by written notice to all other parties. Each such notice, request and demand shall be deemed given or made as follows: (a) if sent by hand delivery, upon delivery; (b) if sent by mail, upon the earlier of the date of receipt or three (3) days after deposit in the U.S. mail, first class and postage prepaid; and (c) if sent by telecopy, upon receipt.

Section 7.3 **Costs, Expenses and Attorneys' Fees.** Borrowers shall pay to Bank immediately upon demand the full amount of all payments, advances, charges, costs and expenses, including reasonable attorneys' fees (to include outside counsel fees and all allocated costs of Bank's in-house counsel), expended or incurred by Bank in connection with (a) the negotiation and preparation of this Agreement and the other Loan Documents (which the parties hereto agree shall not exceed \$2,500), Bank's continued administration hereof and thereof, and the preparation of any amendments and waivers hereto and thereto, (b) the enforcement and protection of Bank's rights and remedies and/or the collection

of any amounts which become due to Bank under any of the Loan Documents, by law or otherwise, and (c) the prosecution or defense of any action in any way related to any of the Loan Documents, including without limitation, any action for declaratory relief, whether incurred at the trial or appellate level, in an arbitration proceeding or otherwise, and including any of the foregoing incurred in connection with any bankruptcy proceeding (including without limitation, any adversary proceeding, contested matter or motion brought by Bank or any other person) relating to any Borrower or any other person or entity.

Section 7.4 Successors, Assignment. This Agreement shall be binding upon and inure to the benefit of the heirs, executors, administrators, legal representatives, successors and assigns of the parties; provided however, that no Borrower may assign or transfer its interests or rights hereunder without Bank's prior written consent. Bank reserves the right to sell, assign, transfer, negotiate or grant participations in all or any part of, or any interest in, Bank's rights and benefits under each of the Loan Documents. In connection therewith, Bank may disclose all documents and information which Bank now has or may hereafter acquire relating to any credit subject hereto, any Borrower or its business, any guarantor hereunder or the business of such guarantor, or any collateral required hereunder.

Section 7.5 Entire Agreement; Amendment. This Agreement and the other Loan Documents constitute the entire agreement between Borrowers and Bank with respect to each credit subject hereto and supersede all prior negotiations, communications, discussions and correspondence concerning the subject matter hereof. This Agreement may be amended or modified only in writing signed by each party hereto.

Section 7.6 No Third Party Beneficiaries. This Agreement is made and entered into for the sole protection and benefit of the parties hereto and their respective permitted successors and assigns, and no other person or entity shall be a third party beneficiary of, or have any direct or indirect cause of action or claim in connection with, this Agreement or any other of the Loan Documents to which it is not a party.

Section 7.7 Time. Time is of the essence of each and every provision of this Agreement and each other of the Loan Documents.

Section 7.8 Severability of Provisions. If any provision of this Agreement shall be prohibited by or invalid under applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity without invalidating the remainder of such provision or any remaining provisions of this Agreement.

Section 7.9 Counterparts. This Agreement may be executed in any number of counterparts, each of which when executed and delivered shall be deemed to be an original, and all of which when taken together shall constitute one and the same Agreement.

Section 7.10 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Minnesota.

Section 7.11 Arbitration.

- (a) Arbitration. The parties hereto agree, upon demand by any party, to submit to binding arbitration all claims, disputes and controversies between or among them (and their respective employees, officers, directors, attorneys, and other agents), whether in tort, contract or otherwise in any way arising out of or relating to (i) any credit subject hereto, or any of the Loan Documents, and their negotiation, execution, collateralization, administration, repayment,

modification, extension, substitution, formation, inducement, enforcement, default or termination; or (ii) requests for additional credit.

(b) Governing Rules. Any arbitration proceeding will (i) proceed in a location in Minnesota selected by the American Arbitration Association (“AAA”); (ii) be governed by the Federal Arbitration Act (Title 9 of the United States Code), notwithstanding any conflicting choice of law provision in any of the documents between the parties; and (iii) be conducted by the AAA, or such other administrator as the parties shall mutually agree upon, in accordance with the AAA’s commercial dispute resolution procedures, unless the claim or counterclaim is at least \$1,000,000.00 exclusive of claimed interest, arbitration fees and costs in which case the arbitration shall be conducted in accordance with the AAA’s optional procedures for large, complex commercial disputes (the commercial dispute resolution procedures or the optional procedures for large, complex commercial disputes to be referred to herein, as applicable, as the “Rules”). If there is any inconsistency between the terms hereof and the Rules, the terms and procedures set forth herein shall control. Any party who fails or refuses to submit to arbitration following a demand by any other party shall bear all costs and expenses incurred by such other party in compelling arbitration of any dispute. Nothing contained herein shall be deemed to be a waiver by any party that is a bank of the protections afforded to it under 12 U.S.C. §91 or any similar applicable state law.

(c) No Waiver of Provisional Remedies, Self-Help and Foreclosure The arbitration requirement does not limit the right of any party to (i) foreclose against real or personal property collateral; (ii) exercise self-help remedies relating to collateral or proceeds of collateral such as setoff or repossession; or (iii) obtain provisional or ancillary remedies such as replevin, injunctive relief, attachment or the appointment of a receiver, before during or after the pendency of any arbitration proceeding. This exclusion does not constitute a waiver of the right or obligation of any party to submit any dispute to arbitration or reference hereunder, including those arising from the exercise of the actions detailed in sections (i), (ii) and (iii) of this paragraph.

(d) Arbitrator Qualifications and Powers. Any arbitration proceeding in which the amount in controversy is \$5,000,000.00 or less will be decided by a single arbitrator selected according to the Rules, and who shall not render an award of greater than \$5,000,000.00. Any dispute in which the amount in controversy exceeds \$5,000,000.00 shall be decided by majority vote of a panel of three arbitrators; provided however, that all three arbitrators must actively participate in all hearings and deliberations. The arbitrator will be a neutral attorney licensed in the State of Minnesota or a neutral retired judge of the state or federal judiciary of Minnesota, in either case with a minimum of ten years experience in the substantive law applicable to the subject matter of the dispute to be arbitrated. The arbitrator will determine whether or not an issue is arbitratable and will give effect to the statutes of limitation in determining any claim. In any arbitration proceeding the arbitrator will decide (by documents only or with a hearing at the arbitrator’s discretion) any pre-hearing motions which are similar to motions to dismiss for failure to state a claim or motions for summary adjudication. The arbitrator shall resolve all disputes in accordance with the substantive law of Minnesota and may grant any remedy or relief that a court of such state could order or grant within the scope hereof and such ancillary relief as is necessary to make effective any award. The arbitrator shall also have the power to award recovery of all costs and fees, to impose sanctions and to take such other action as the arbitrator deems necessary to the same extent a judge could pursuant to the Federal Rules of Civil Procedure, the Minnesota Rules of Civil Procedure or other applicable law. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy shall not constitute a

waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief.

(e) Discovery. In any arbitration proceeding, discovery will be permitted in accordance with the Rules. All discovery shall be expressly limited to matters directly relevant to the dispute being arbitrated and must be completed no later than 20 days before the hearing date. Any requests for an extension of the discovery periods, or any discovery disputes, will be subject to final determination by the arbitrator upon a showing that the request for discovery is essential for the party's presentation and that no alternative means for obtaining information is available.

(f) Class Proceedings and Consolidations. No party hereto shall be entitled to join or consolidate disputes by or against others in any arbitration, except parties who have executed any Loan Document, or to include in any arbitration any dispute as a representative or member of a class, or to act in any arbitration in the interest of the general public or in a private attorney general capacity.

(g) Payment Of Arbitration Costs And Fees. The arbitrator shall award all costs and expenses of the arbitration proceeding.

(h) Miscellaneous. To the maximum extent practicable, the AAA, the arbitrators and the parties shall take all action required to conclude any arbitration proceeding within 180 days of the filing of the dispute with the AAA. No arbitrator or other party to an arbitration proceeding may disclose the existence, content or results thereof, except for disclosures of information by a party required in the ordinary course of its business or by applicable law or regulation. If more than one agreement for arbitration by or between the parties potentially applies to a dispute, the arbitration provision most directly related to the Loan Documents or the subject matter of the dispute shall control. This arbitration provision shall survive termination, amendment or expiration of any of the Loan Documents or any relationship between the parties.

Section 7.12 Joint and Several Liability. Each Borrower agrees that it is jointly and severally liable for, and absolutely and unconditionally guarantees to Bank the prompt payment and performance of, all loans, debts, principal, interest, reimbursement or indemnification obligations, premiums, liabilities, obligations, fees, expenses, guaranties and all covenants and duties of any other kind and description owing by any Borrower, whether direct or indirect, absolute or contingent, due or to become due, sole, joint, several or joint and several, now existing or hereafter arising, pursuant to or evidenced by this Agreement or any other Loan Document. Each Borrower agrees that its guaranty obligations hereunder constitute a continuing guaranty of payment and not of collection, that such obligations shall not be discharged until cash payment in full of the obligations, and that such obligations are absolute and unconditional, irrespective of (a) the genuineness, validity, regularity, enforceability, subordination or any future modification of, or change in, any obligations or Loan Document, or any other document, instrument or agreement to which any Borrower is or may become a party or be bound; (b) the absence of any action to enforce this Agreement (including this Section) or any other Loan Document, or any waiver, consent or indulgence of any kind by Bank with respect thereto; (c) the existence, value or condition of, or failure to perfect any of Bank's liens or to preserve rights against, any security or guaranty for the obligations or any action, or the absence of any action, by Bank in respect thereof (including the release of any security or guaranty); (d) the insolvency of any Borrower; (e) any election by Bank in an insolvency proceeding for the application of Section 1111(b)(2) of the Bankruptcy Code; (f) any borrowing or grant of a lien, security interest or other encumbrance by any other Borrower, as debtor-in-possession under Section 364 of the Bankruptcy Code or otherwise; (g) the disallowance of any claims of Bank against any Borrower for the repayment of any obligations under Section 502 of the Bankruptcy Code or otherwise; or (h) any other action or circumstances that might otherwise constitute a legal or equitable discharge or defense of a surety or guarantor, except cash payment in full of all obligations.

Signature pages follow

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the day and year first written above.

COMMUNICATIONS SYSTEMS, INC.

By: /s/ David T. McGraw
Name: David T. McGraw
Title: Chief Financial Officer

JDL TECHNOLOGIES, INCORPORATED

By: /s/ David T. McGraw
Name: David T. McGraw
Title: Chief Financial Officer

TRANSITION NETWORKS, INC.

By: /s/ David T. McGraw
Name: David T. McGraw
Title: Chief Financial Officer

Signature Page to Credit Agreement

**WELLS FARGO BANK, NATIONAL
ASSOCIATION**

By: /s/ Michael M. Lebens
Name: Michael M. Lebens
Title: Vice President

Signature Page to Credit Agreement

Litigation

None.

Schedule 2.4

Environmental Matters

None.

Schedule 2.11

Real Property

Owned:

Communications Systems: 10900 Red Circle Drive, Minnetonka, MN 55343
Communications Systems (Suttle): 1001 Highway 212, Hector, MN 55342
Communications Systems (Suttle): 951 Building, Hector, MN 55342
Communications Systems (Suttle): 901 Building, Hector, MN 55342
Communications Systems (Suttle): 230 Elm Street, Hector, MN 55342
Communications Systems (Suttle): 213 Main Street, Hector, MN 55342
Communications Systems (Suttle): 541 8th Street NE, Hector, MN 55342

Leased:

5450 Northwest 33rd Avenue, Ft. Lauderdale, FL

Foreign Locations:

Leased: 9F AAE Plaza No. 28, Jiangchange No. 3 Rd., Shanghai, China
Leased: 1030 Moorpark Avenue Sutie 232, San Jose, CA
Leased: Costa Rica property
Owned: Austin Taylor, Bethesda, Gwynedd, North Wales, United Kingdom, LL57 3BX

Intellectual Property

None.

Schedule 2.14

Existing Indebtedness

Building Loan by Monumental Life Insurance Company, as lender, to Transition Networks, with a principal balance as of June 30, 2011 of \$2,205,345 and maturing on March 1, 2016.

Schedule 5.2

Existing Loans, Advances and Investments

Loan(s) by Communications Systems to Austin Taylor, in an amount not to exceed \$3,297,077, as evidenced by that certain Demand Promissory Note of Austin Taylor dated July 1, 2011 payable to Communications Systems.

Schedule 5.6

Existing Liens

Debtor Searched [Debtor Found]	Jurisdiction	Secured Party	Filing No.	Filing Date	Lien Description
Communications Systems Inc	Minnesota Secretary of State	US Bancorp	201020348066	05/24/10	Specific equipment
JDL Technologies, Incorporated	Minnesota Secretary of State	Mitel Networks, Inc.	200813949308	11/20/08	Inventory acquired from Mitel Networks, Inc., Proceeds, Accounts Receivable and Contract Rights, all pertaining to Inventory acquired from Mitel Networks, Inc.
JDL Technologies, Incorporated	Minnesota Secretary of State	Mitel Leasing, Inc.	200915220890	03/06/09	Axxcessory Talk VM System (Rental)
JDL Technologies, Incorporated	Minnesota Secretary of State	GE Commercial Distribution Finance Corporation	200916106668	05/15/09	All personal property of Debtor, whether such property or Debtor's right, title or interest therein or thereto is now owned or existing or hereafter acquired or arising, and wherever located, including, without limitation, all accounts, inventory, equipment, fixtures, other goods, general intangibles, chattel paper, instruments, deposit accounts, investment property and documents, and all products and proceeds of the foregoing

Schedule 5.7

Debtor Searched [Debtor Found]	Jurisdiction	Secured Party	Filing No.	Filing Date	Lien Description
Transition Networks, Inc.	Minnesota Secretary of State	Monumental Life Insurance Company	200718510660	10/09/07	All those assets that relate to the property commonly known as 10900 Red Circle Dr, Minnetonka, MN (and legally described as Lots 7 and 8, Block 1, and that part of Lot 6, Block 1, Opus 2 Eighth Addition, Hennepin Co, MN) and more particularly described in that certain Mortgage; covered assets include Accounts, Chattel Paper, Deposit Accounts, Documents, Equipment, Goods, Instruments, General Intangibles, Investment Property, and Letter of Credit Rights

Schedule 5.7

REVOLVING LINE OF CREDIT NOTE

\$10,000,000

Minnetonka, Minnesota
October 28, 2011

FOR VALUE RECEIVED, the undersigned COMMUNICATIONS SYSTEMS, INC., a Minnesota corporation (“**Communications Systems**”), JDL TECHNOLOGIES, INCORPORATED, a Minnesota corporation (“**JDL**”), TRANSITION NETWORKS, INC., a Minnesota corporation (“**Transition Networks**”); together with Communications Systems and JDL, “**Borrowers**” and each a “**Borrower**”), promises to pay on November 1, 2013 (the “**Maturity Date**”) to the order of WELLS FARGO BANK, NATIONAL ASSOCIATION (“**Bank**”) at its office at 7900 Xerxes Avenue S., Suite 2300, Bloomington, MN 55431, Minnesota, or at such other place as the holder hereof may designate, in lawful money of the United States of America and in immediately available funds, the principal sum of TEN MILLION Dollars (\$10,000,000), or so much thereof as may be advanced and be outstanding, with interest thereon, to be computed on each advance from the date of its disbursement as set forth herein.

DEFINITIONS:

As used herein, the following terms shall have the meanings set forth after each, and any other term defined in this Note shall have the meaning set forth at the place defined:

- (a) “**Business Day**” means any day except a Saturday, Sunday or any other day on which commercial banks in Minnesota are authorized or required by law to close.
- (b) “**Daily One Month LIBOR**” means, for any day, the rate of interest equal to LIBOR then in effect for delivery for a one (1) month period.
- (c) “**LIBOR**” means the rate per annum (rounded upward, if necessary, to the nearest whole 1/8 of 1%) and determined pursuant to the following formula:

$$\text{LIBOR} = \frac{\text{Base LIBOR}}{100\% - \text{LIBOR Reserve Percentage}}$$

(i) “**Base LIBOR**” means the rate per annum for United States dollar deposits quoted by Bank as the Inter-Bank Market Offered Rate, with the understanding that such rate is quoted by Bank for the purpose of calculating effective rates of interest for loans making reference thereto, for delivery of funds for one (1) month in an amount equal to the outstanding principal balance of this Note. Borrower understands and agrees that Bank may base its quotation of the Inter-Bank Market Offered Rate upon such offers or other market indicators of the Inter-Bank Market as Bank in its discretion deems appropriate including, but not limited to, the rate offered for U.S. dollar deposits on the London Inter-Bank Market.

(ii) “**LIBOR Reserve Percentage**” means the reserve percentage prescribed by the Board of Governors of the Federal Reserve System (or any successor) for “Eurocurrency Liabilities” (as defined in Regulation D of the Federal Reserve Board, as amended), adjusted by Bank for expected changes in such reserve percentage during the term of this Note.



INTEREST:

(a) Interest. The outstanding principal balance of this Note shall bear interest (computed on the basis of a 360-day year, actual days elapsed) at a fluctuating rate per annum determined by Bank to be one and one-tenth of one percent (1.10%) above Daily One Month LIBOR in effect from time to time. Each change in the rate of interest hereunder shall become effective on each Business Day a change in Daily One Month LIBOR is announced within Bank. Bank is hereby authorized to note the date and interest rate applicable to this Note and any payments made thereon on Bank's books and records (either manually or by electronic entry) and/or on any schedule attached to this Note, which notations shall be prima facie evidence of the accuracy of the information noted.

(b) Taxes and Regulatory Costs. Borrowers shall pay to Bank immediately upon demand, in addition to any other amounts due or to become due hereunder, any and all (i) withholdings, interest equalization taxes, stamp taxes or other taxes (except income and franchise taxes) imposed by any domestic or foreign governmental authority and related in any manner to LIBOR, and (ii) future, supplemental, emergency or other changes in the LIBOR Reserve Percentage, assessment rates imposed by the Federal Deposit Insurance Corporation, or similar requirements or costs imposed by any domestic or foreign governmental authority or resulting from compliance by Bank with any request or directive (whether or not having the force of law) from any central bank or other governmental authority and related in any manner to LIBOR to the extent they are not included in the calculation of LIBOR. In determining which of the foregoing are attributable to any LIBOR option available to Borrowers hereunder, any reasonable allocation made by Bank among its operations shall be conclusive and binding upon Borrower.

(c) Payment of Interest. Interest accrued on this Note shall be payable on the first day of each month, commencing December 1, 2011.

(d) Default Interest. From and after the maturity date of this Note, or such earlier date as all principal owing hereunder becomes due and payable by acceleration or otherwise, or at Bank's option upon the occurrence, and during the continuance of an Event of Default, the outstanding principal balance of this Note shall bear interest at an increased rate per annum (computed on the basis of a 360-day year, actual days elapsed) equal to four percent (4%) above the rate of interest from time to time applicable to this Note.

BORROWING AND REPAYMENT:

(a) Borrowing and Repayment. Borrowers may from time to time during the term of this Note borrow, partially or wholly repay its outstanding borrowings, and reborrow, subject to all of the limitations, terms and conditions of this Note and of any document executed in connection with or governing this Note; provided however, that the total outstanding borrowings under this Note shall not at any time exceed the principal amount stated above. The unpaid principal balance of this obligation at any time shall be the total amounts advanced hereunder by the holder hereof less the amount of principal payments made hereon by or for Borrowers, which balance may be endorsed hereon from time to time by the holder. The outstanding principal balance of this Note shall be due and payable in full on the Maturity Date.

(b) Advances. Advances hereunder, to the total amount of the principal sum stated above, may be made by the holder at the oral or written request of any officer of any Borrower, until written notice of the revocation of such authority is received by the holder at the office designated above, or (ii) any person, with respect to advances deposited to the credit of any deposit account of any Borrower, which advances, when so deposited, shall be conclusively presumed to have been made to or for the benefit of Borrowers regardless of the fact that persons other than those authorized to request advances may have authority to draw against such account. The holder shall have no obligation to determine whether any person requesting an advance is or has been authorized by Borrowers.

(c) Application of Payments. Each payment made on this Note shall be credited first, to any interest then due and second, to the outstanding principal balance hereof.

EVENTS OF DEFAULT:

This Note is made pursuant to and is subject to the terms and conditions of that certain Credit Agreement among Borrowers and Bank dated as of October 28, 2011 (as amended, restated, supplemented or otherwise modified from time to time, the "**Credit Agreement**"). Any default in the payment or performance of any obligation under this Note, or the occurrence of any Event of Default (as defined in the Credit Agreement) under the Credit Agreement, shall constitute an "Event of Default" under this Note.

MISCELLANEOUS:

(a) Remedies. Upon the occurrence of any Event of Default, the holder of this Note, at the holder's option, may declare all sums of principal and interest outstanding hereunder to be immediately due and payable without presentment, demand, notice of nonperformance, notice of protest, protest or notice of dishonor, all of which are expressly waived by each Borrower, and the obligation, if any, of the holder to extend any further credit hereunder shall immediately cease and terminate. Borrowers shall pay to the holder immediately upon demand the full amount of all payments, advances, charges, costs and expenses, including reasonable attorneys' fees (to include outside counsel fees and all allocated costs of the holder's in-house counsel), expended or incurred by the holder in connection with the enforcement of the holder's rights and/or the collection of any amounts which become due to the holder under this Note, and the prosecution or defense of any action in any way related to this Note, including without limitation, any action for declaratory relief, whether incurred at the trial or appellate level, in an arbitration proceeding or otherwise, and including any of the foregoing incurred in connection with any bankruptcy proceeding (including without limitation, any adversary proceeding, contested matter or motion brought by Bank or any other person) relating to Borrowers or any other person or entity.

(b) Obligations Joint and Several. Should more than one person or entity sign this Note as a Borrower, the obligations of each such Borrower shall be joint and several.

(c) Governing Law. This Note shall be governed by and construed in accordance with the laws of the State of Minnesota.

Signature page follows

IN WITNESS WHEREOF, the undersigned has executed this Note as of the date first written above.

COMMUNICATIONS SYSTEMS, INC.

By: /s/ David T. McGraw
Name: David T. McGraw
Title: Chief Financial Officer

JDL TECHNOLOGIES, INCORPORATED

By: /s/ David T. McGraw
Name: David T. McGraw
Title: Chief Financial Officer

TRANSITION NETWORKS, INC.

By: /s/ David T. McGraw
Name: David T. McGraw
Title: Chief Financial Officer

Signature Page to Revolving Note

COMMUNICATIONS SYSTEMS, INC.

STOCK PLAN

(as amended through August 11, 2011)

SECTION 1. General Purpose of Plan; Definitions.

The name of this plan is the Communications Systems, Inc. Stock Plan (the "Plan"). The purpose of the Plan is to enable Communications Systems, Inc. (the "Company") and its Subsidiaries to retain and attract executives and other key employees who contribute to the Company's success by their ability, ingenuity and industry, and to enable such individuals to participate in the long-term success and growth of the Company by giving them a proprietary interest in the Company.

For purposes of the Plan, the following terms shall be defined as set forth below:

- (a) "Board" means the Board of Directors of the Company.
- (b) "Cause" means a felony conviction of a participant or the failure of a participant to contest prosecution for a felony, or a participant's willful misconduct or dishonesty, any of which is directly and materially harmful to the business or reputation of the Company.
- (c) "Code" means the Internal Revenue Code of 1986, as amended.
- (d) "Committee" means the Committee referred to in Section 2 of the Plan. If at any time no Committee shall be in office, then the functions of the Committee specified in the Plan shall be exercised by the Board.
- (e) "Company" means Communications Systems, Inc., a corporation organized under the laws of the State of Minnesota (or any successor corporation).
- (f) "Continuing Directors" means (i) individuals who on the effective date of the Plan constituted the Board of Directors of the Company, and (ii) any new director who subsequent to the effective date of the Plan is elected or nominated for election by a majority of the directors who held such office immediately prior to any of the events involving a change in ownership or control described in Sections 5(c) and 7(c)(v).
- (g) "Deferred Stock" means an award made pursuant to Section 8 below of the right to receive Stock at the end of a specified deferral period.
- (h) "Disability" means permanent and total disability as determined by the Committee.

- (i) “Disinterested Director” shall have the meaning set forth in Rule 16b-3(c)(2) as promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, or any successor definition adopted by the Commission.
- (j) “Early Retirement” means retirement, with consent of the Committee at the time of retirement, from active employment with the Company and any Subsidiary or Parent Corporation of the Company.
- (k) “Fair Market Value” means the value of the Stock on a given date as determined by the Committee in accordance with Section 422 of the Code and any applicable Treasury Department regulations with respect to incentive stock options.
- (l) “Incentive Stock Option” means any Stock Option intended to be and designated as an “Incentive Stock Option” within the meaning of Section 422 of the Code.
- (m) “Non-Qualified Stock Option” means any Stock Option that is not an Incentive Stock Option, and is intended to be and is designated as a “Non-Qualified Stock Option.”
- (n) “Normal Retirement” means retirement from active employment with the Company and any Subsidiary or Parent Corporation of the Company on or after age 65.
- (o) “Ownership Change” means an “ownership change” as defined in Section 382(g) of the Code determined without regard to Section 382(i)(3) of the Code.
- (p) “Parent Corporation” means any corporation (other than the Company) in an unbroken chain of corporations ending with the Company if each of the corporations (other than the Company) owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.
- (q) “Restricted Stock” means an award of shares of Stock that are subject to restrictions under Section 7 below.
- (r) “Retirement” means Normal Retirement or Early Retirement.
- (s) “Stock” means the Common Stock, \$.05 par value per share, of the Company.
- (t) “Stock Appreciation Right” means the right pursuant to an award granted under Section 6 below to surrender to the Company all or a portion of a Stock Option in exchange for an amount equal to the difference between (i) the Fair Market Value, as of the date such Stock Option or such portion thereof is surrendered, of the shares of Stock covered by such Stock Option or such portion thereof, and (ii) the aggregate exercise price of such Stock Option or such portion thereof.

- (u) “Stock Option” means any option to purchase shares of Stock granted pursuant to Section 5 below.
- (v) “Subsidiary” means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company if each of the corporations (other than the last corporation in the unbroken chain) owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

SECTION 2. Administration.

The Plan shall be administered by the Board of Directors or by a Committee of not less than three Disinterested Directors, who shall be appointed by the Board of Directors of the Company and who shall serve at the pleasure of the Board. If the Plan is administered by the Board, each member of the Board shall be a Disinterested Director.

The Committee shall have the power and authority to grant to eligible employees, pursuant to the terms of the Plan: (i) Stock Options, (ii) Stock Appreciation Rights, (iii) Restricted Stock, and (iv) Deferred Stock awards.

In particular, the Committee shall have the authority:

- (i) to select the officers and other key employees of the Company and its Subsidiaries to whom Stock Options, Stock Appreciation Rights, Restricted Stock and/or Deferred Stock awards may from time to time be granted hereunder;
- (ii) to determine whether and to what extent Incentive Stock Options, Non-Qualified Stock Options, Stock Appreciation Rights, Restricted Stock or Deferred Stock awards, or a combination of the foregoing, are to be granted hereunder;
- (iii) to determine the number of shares to be covered by each such award granted hereunder;
- (iv) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any award granted hereunder (including, but not limited to, any restriction on any Stock Option or other award and/or the shares of Stock relating thereto); and
- (v) to determine whether, to what extent and under what circumstances Stock and other amounts payable with respect to an award under this Plan shall be deferred either automatically or at the election of the participant.

The Committee shall have the authority to adopt, alter and repeal such administrative rules, guidelines and practices governing the Plan as it shall, from time to time, deem advisable; to interpret the terms and provisions of the Plan and any award issued under the Plan (and any agreements relating thereto); and to otherwise supervise the administration of the Plan. The Committee may delegate its authority to officers of the Company for the purpose of selecting employees who are not officers of the Company for purposes of (i) above.

All decisions made by the Committee pursuant to the provisions of the Plan shall be final and binding on all persons, including the Company and Plan participants.

SECTION 3. Stock Subject to Plan.

The total number of shares of Stock reserved and available for distribution under the Plan shall be 2,500,000.¹ Such shares may consist, in whole or in part, of authorized and unissued shares.

Subject to paragraph (b)(iv) of Section 6 below, if any shares that have been optioned cease to be subject to Stock Options, or if any shares subject to any Restricted Stock or Deferred Stock award granted hereunder are forfeited or such award otherwise terminates without a payment being made to the participant, such shares shall again be available for distribution in connection with future awards under the Plan.

In the event of any merger, reorganization, consolidation, recapitalization, stock dividend, other change in corporate structure affecting the Stock, or spin-off or other distribution of assets to shareholders, such substitution or adjustment shall be made in the aggregate number of shares reserved for issuance under the Plan, in the number and option price of shares subject to outstanding options granted under the Plan, and in the number of shares subject to Restricted Stock or Deferred Stock awards granted under the Plan as may be determined to be appropriate by the Committee, in its sole discretion, provided that the number of shares subject to any award shall always be a whole number. Such adjusted option price shall also be used to determine the amount payable by the Company upon the exercise of any Stock Appreciation Right associated with any Stock Option.

SECTION 4. Eligibility.

Officers and other key employees of the Company and its Subsidiaries who are responsible for or contribute to the management, growth and/or profitability of the business of the Company and its Subsidiaries are eligible to be granted Stock Options, Stock Appreciation Rights, Restricted Stock or Deferred Stock awards under the Plan. The optionees and participants under the Plan shall be selected from time to time by the Committee, in its sole discretion, from among those eligible, and the Committee shall determine, in its sole discretion, the number of shares covered by each award; provided that, the Committee shall have no authority to grant any awards under the Plan after August 11, 2011.²

¹ Amended by Board and Shareholder action in 1995 to increase authorized shares to 900,000 shares, in 1998 to increase authorized shares to 1,400,000, in 1999 to increase authorized shares to 1,900,000 and in 2004 to increase authorized shares to 2,500,000.

² Last clause added by Board action on August 11, 2011.

SECTION 5. Stock Options.

Any Stock Option granted under the Plan shall be in such form as the Committee may from time to time approve.

The Stock Options granted under the Plan may be of two types: (i) Incentive Stock Options and (ii) Non-Qualified Stock Options.³

The Committee shall have the authority to grant any optionee Incentive Stock Options, Non-Qualified Stock Options, or both types of options in each case with or without Stock Appreciation Rights. To the extent that any option does not qualify as an Incentive Stock Option, it shall constitute a separate Non-Qualified Stock Option.

Anything in the Plan to the contrary notwithstanding, no term of this Plan relating to Incentive Stock Options shall be interpreted, amended or altered, nor shall any discretion or authority granted under the Plan be so exercised, so as to disqualify either the Plan or any Incentive Stock Option under Section 422 of the Code. The preceding sentence shall not preclude any modification or amendment to an outstanding Incentive Stock Option, whether or not such modification or amendment results in disqualification of such Stock Option as an Incentive Stock Option, provided the optionee consents in writing to the modification or amendment.

Stock Options granted under the Plan shall be subject to the following terms and conditions and shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as the Committee shall deem desirable.

- (a) Option Price. The option price per share of Stock purchasable under a Stock Option shall be determined by the Committee at the time of grant and may, except as provided in this paragraph, be less than the Fair Market Value of the Stock on the date the Stock Option is granted. In the event that the Committee does not determine the exercise price per share of Stock purchasable under a Stock Option, the exercise price shall be the Fair Market Value of the Stock on the date the Stock Option is granted except as otherwise required in this paragraph. In no event shall the Stock Option price per share of Stock purchasable under an Incentive Stock Option or a Non-Qualified Stock Option be less than 100% or 50%, respectively, of the Fair Market Value of the Stock on the date the Stock Option is granted. If an employee owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation or Subsidiary and an Incentive Stock Option is granted to such employee, the exercise price shall be no less than 110% of the Fair Market Value of the Stock on the date the Stock Option is granted.

³ A second sentence in effect prior to January 1, 2002 regarding the term of the Plan was deleted effective as of January 1, 2002 concurrent with a related amendment adding a new paragraph under Section 10.

- (b) Option Term. The term of each Stock Option shall be fixed by the Committee, but no Incentive Stock Option shall be exercisable more than ten years after the date the Stock Option is granted. In the event that the Committee does not fix the term of a Stock Option, the term shall be ten years from the date the Stock Option is granted. Notwithstanding the foregoing, if an employee owns or is deemed to own (by reason of the attribution rules of Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation or Subsidiary and an Incentive Stock Option is granted to such employee, the term of such Stock Option shall be no more than five years from the date of grant.
- (c) Exercisability. Stock Options shall be exercisable at such time or times as determined by the Committee at or after grant. In the event that the Committee does not determine the time at which a Stock Option shall be exercisable, such Stock Option shall be exercisable one year after the date of grant. If the Committee provides, in its discretion, that any Stock Option is exercisable only in installments, the Committee may waive such installment exercise provisions at any time.

Notwithstanding the foregoing, unless the Stock Option Agreement provides otherwise, any Stock Option granted under this Plan shall be exercisable in full, without regard to any installment exercise provisions, for a period specified by the Company, but not to exceed sixty (60) days, prior to the occurrence of any of the following events: (i) dissolution or liquidation of the Company other than in conjunction with a bankruptcy of the Company or any similar occurrence, (ii) any merger, consolidation, acquisition, separation, reorganization, or similar occurrence, where the Company will not be the surviving entity, (iii) the transfer of substantially all of the assets of the Company, (iv) a direct or indirect acquisition or series of acquisitions of shares of stock of the Company, by any person, corporation or other entity, including but not limited to acquisitions by reason of merger, consolidation or tender offer, which results in an Ownership Change, or (v) a majority of the Board of Directors ceases to be composed of individuals who are Continuing Directors or any other event shall occur which would be required to be reported as a change in control in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, whether or not the Company is then subject to such reporting requirements.

- (d) Method of Exercise. Stock Options may be exercised in whole or in part at any time during the option period by giving written notice of exercise to the Company specifying the number of shares to be purchased. Such notice shall be accompanied by payment in full of the purchase price, either by certified or bank check, or by any other form of legal consideration deemed sufficient by the Committee and consistent with the Plan's purpose and applicable law, including promissory notes or a properly executed exercise notice together with irrevocable instructions to a broker acceptable to the Company to promptly deliver to the Company the amount of sale or loan proceeds to pay the exercise price. As determined by the Committee, in its sole discretion, payment in full or in part may also be made in the form of unrestricted Stock already owned by the optionee or, in the case of the exercise of a Non-Qualified Stock Option, Restricted Stock or Deferred Stock subject to an award hereunder (based, in each case, on the Fair Market Value of the Stock on the date the option is exercised, as determined by the Committee), provided, however, that, in the case of an Incentive Stock Option, the right to make a payment in the form of already owned shares may be authorized only at the time the option is granted, and provided further that in the event payment is made in the form of shares of Restricted Stock or a Deferred Stock award, the optionee will receive a portion of the option shares in the form of, and in an amount equal to, the Restricted Stock or Deferred Stock award tendered as payment by the optionee. If the terms of a Stock Option so permit, an optionee may elect to pay all or part of the exercise price by having the Company withhold from the shares of Stock that would otherwise be issued upon exercise that number of shares of Stock having a Fair Market Value equal to the aggregate exercise price for the shares with respect to which such election is made. No shares of Stock shall be issued until full payment therefore has been made. An optionee shall generally have the rights to dividends and other rights of a shareholder with respect to shares subject to the option when the optionee has given written notice of exercise, has paid in full for such shares, and, if requested, has given the representation described in paragraph (a) of Section 12.
- (e) Non-Transferability of Options. No Stock Option shall be transferable by the optionee otherwise than by will or by the laws of descent and distribution, and all Stock Options shall be exercisable, during the optionee's lifetime, only by the optionee.
- (f) Termination by Death. If an optionee's employment by the Company and any Subsidiary or Parent Corporation terminates by reason of death, the Stock Option may thereafter be immediately exercised, to the extent then exercisable (or on such accelerated basis as the Committee shall determine at or after grant), by the legal representative of the estate or by the legatee of the optionee under the will of the optionee, for a period of three years (or such shorter period as the Committee shall specify at grant) from the date of such death or until the expiration of the stated term of the option, whichever period is shorter.
- (g) Termination by Reason of Disability. If an optionee's employment by the Company and any Subsidiary or Parent Corporation terminates by reason of Disability, any Stock Option held by such optionee may thereafter be exercised, to the extent it was exercisable at the time of termination due to Disability (or on such accelerated basis as the Committee shall determine at or after grant), but may not be exercised after three years (or such shorter period as the Committee shall specify at grant) from the date of such termination of employment or the expiration of the stated term of the option, whichever period is shorter. In the event of termination of employment by reason of Disability, if an Incentive Stock Option is exercised after the expiration of the exercise periods that apply for purposes of Section 422 of the Code, the option will thereafter be treated as a Non-Qualified Stock Option.

- (h) Termination by Reason of Retirement. If an optionee's employment by the Company and any Subsidiary or Parent Corporation terminates by reason of Retirement, any Stock Option held by such optionee may thereafter be exercised to the extent it was exercisable at the time of such Retirement, but may not be exercised after three years (or such shorter period as Committee shall specify at grant) from the date of such termination of employment or the expiration of the stated term of the option, whichever period is shorter. In the event of termination of employment by reason of Retirement, if an Incentive Stock Option is exercised after the expiration of the exercise periods that apply for purposes of Section 422 of the Code, the option will thereafter be treated as a Non-Qualified Stock Option.
- (i) Other Termination. Unless otherwise determined by the Committee, if an optionee's employment by the Company and any Subsidiary or Parent Corporation terminates for any reason other than death, Disability or Retirement, the Stock Option shall thereupon terminate, except that the option may be exercised to the extent it was exercisable at such termination for the lesser of three months or the balance of the option's term if the optionee is involuntarily terminated without Cause by the Company and any Subsidiary or Parent Corporation.
- (j) Annual Limit on Incentive Stock Options. The aggregate Fair Market Value (determined as of the time the Stock Option is granted) of the Common Stock with respect to which an Incentive Stock Option under this Plan or any other plan of the Company and any Subsidiary or Parent Corporation is exercisable for the first time by an optionee during any calendar year shall not exceed \$100,000.

SECTION 6. Stock Appreciation Rights.

- (a) Grant and Exercise. Stock Appreciation Rights may be granted in conjunction with all or part of any Stock Option granted under the Plan. In the case of a Non-Qualified Stock Option, such rights may be granted either at or after the time of the grant of such Option. In the case of an Incentive Stock Option, such rights may be granted only at the time of the grant of the Stock Option.

A Stock Appreciation Right or applicable portion thereof granted with respect to a given Stock Option shall terminate and no longer be exercisable upon the termination or exercise of the related Stock Option, except that a Stock Appreciation Right granted with respect to less than the full number of shares covered by a related Stock Option shall not be reduced until the exercise or termination of the related Stock Option exceeds the number of shares not covered by the Stock Appreciation Right.

A Stock Appreciation Right may be exercised by an optionee, in accordance with paragraph (b) of this Section, by surrendering the applicable portion of the related Stock Option. Upon such exercise and surrender, the optionee shall be entitled to receive an amount determined in the manner prescribed in paragraph (b) of this Section. Stock Options which have been so surrendered, in whole or in part, shall no longer be exercisable to the extent the related Stock Appreciation Rights have been exercised.

- (b) Terms and Conditions. Stock Appreciation Rights shall be subject to such terms and conditions, not inconsistent with the provisions of the Plan, as shall be determined from time to time by the Committee, including the following:
- (i) Stock Appreciation Rights shall be exercisable only at such time or times and to the extent that the Stock Options to which they relate shall be exercisable in accordance with the provisions of Section 5 and this Section of the Plan.
 - (ii) Upon the exercise of a Stock Appreciation Right, an optionee shall be entitled to receive up to, but not more than, an amount in cash or shares of Stock equal in value to the excess of the Fair Market Value of one share of Stock over the exercise price per share specified in the related option multiplied by the number of shares in respect of which the Stock Appreciation Right shall have been exercised, with the Committee having the right to determine the form of payment.
 - (iii) Stock Appreciation Rights shall be transferable only when and to the extent that the underlying Stock Option would be transferable under Section 5 of the Plan.
 - (iv) Upon the exercise of a Stock Appreciation Right, the Stock Option or part thereof to which such Stock Appreciation Right is related shall be deemed to have been exercised for the purpose of the limitation set forth in Section 3 of the Plan on the number of shares of Stock to be issued under the Plan, but only to the extent of the number of shares issued or issuable under the Stock Appreciation Right at the time of exercise based on the value of the Stock Appreciation Right at such time.
 - (v) A Stock Appreciation Right granted in connection with an Incentive Stock Option may be exercised only if and when the market price of the Stock subject to the Incentive Stock Option exceeds the exercise price of such Option.

SECTION 7. Restricted Stock.

- (a) Administration. Shares of Restricted Stock may be issued either alone or in addition to other awards granted under the Plan. The Committee shall determine the officers and key employees of the Company and Subsidiaries to whom, and the time or times at which, grants of Restricted Stock will be made, the number of shares to be awarded, the time or times within which such awards may be subject to forfeiture, and all other conditions of the awards. The Committee may also condition the grant of Restricted Stock upon the attainment of specified performance goals. The provisions of Restricted Stock awards need not be the same with respect to each recipient.
- (b) Awards and Certificates. The prospective recipient of an award of shares of Restricted Stock shall not have any rights with respect to such award, unless and until such recipient has executed an agreement evidencing the award and has delivered a fully executed copy thereof to the Company, and has otherwise complied with the then applicable terms and conditions.
- (i) Each participant shall be issued a stock certificate in respect of shares of Restricted Stock awarded under the Plan. Such certificate shall be registered in the name of the participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such award, substantially in the following form:
- “The transferability of this certificate and the shares of stock represented hereby are subject to the terms and conditions (including forfeiture) of the Communications Systems, Inc. 1992 Stock Plan and an Agreement entered into between the registered owner and Communications Systems, Inc. Copies of such Plan and Agreement are on file in the offices of Communications Systems, Inc., P.O. Box 777, Hector, MN 55342.”
- (ii) The Committee shall require that the stock certificates evidencing such shares be held in custody by the Company until the restrictions thereon shall have lapsed, and that, as a condition of any Restricted Stock award, the participant shall have delivered a stock power, endorsed in blank, relating to the Stock covered by such award.
- (c) Restrictions and Conditions. The shares of Restricted Stock awarded pursuant to the Plan shall be subject to the following restrictions and conditions:
- (i) Subject to the provisions of this Plan and the award agreement, during a period set by the Committee commencing with the date of such award (the “Restriction Period”), the participant shall not be permitted to sell, transfer, pledge or assign shares of Restricted Stock awarded under the Plan. In no event shall the Restriction Period be less than one (1) year. Within these limits, the Committee may provide for the lapse of such restrictions in installments where deemed appropriate.

- (ii) Except as provided in paragraph (c)(i) of this Section, the participant shall have, with respect to the shares of Restricted Stock, all of the rights of a shareholder of the Company, including the right to vote the shares and the right to receive any cash dividends. The Committee, in its sole discretion, may permit or require the payment of cash dividends to be deferred and, if the Committee so determines, reinvested in additional shares of Restricted Stock (to the extent shares are available under Section 3 and subject to paragraph (f) of Section 12). Certificates for shares of unrestricted Stock shall be delivered to the grantee promptly after, and only after, the period of forfeiture shall have expired without forfeiture in respect of such shares of Restricted Stock.
- (iii) Subject to the provisions of the award agreement and paragraph (c)(iv) of this Section, upon termination of employment for any reason during the Restriction Period, all shares still subject to restriction shall be forfeited by the participant.
- (iv) In the event of special hardship circumstances of a participant whose employment is terminated (other than for Cause), including death, Disability or Retirement, or in the event of an unforeseeable emergency of a participant still in service, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interest of the Company, waive in whole or in part any or all remaining restrictions with respect to such participant's shares of Restricted Stock.
- (v) Notwithstanding the foregoing, all restrictions with respect to any participant's shares of Restricted Stock shall lapse, on the date determined by the Committee, prior to, but in no event more than sixty (60) days prior to, the occurrence of any of the following events: (i) dissolution or liquidation of the Company, other than in conjunction with a bankruptcy of the Company or any similar occurrence, (ii) any merger, consolidation, acquisition, separation, reorganization, or similar occurrence, where the Company will not be the surviving entity, (iii) the transfer of substantially all of the assets of the Company, (iv) a direct or indirect acquisition or series of acquisitions of shares of stock of the Company, by any person, corporation or other entity, included but not limited to acquisitions by reason of merger, consolidation or tender offer, which results in an Ownership Change, or (v) a majority of the Board of Directors ceases to be composed of individuals who are Continuing Directors or any other event shall occur which would be required to be reported as a change in control in response to Item 6(c) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, whether or not the Company is then subject to such reporting requirements.

SECTION 8. Deferred Stock Awards.

- (a) Administration. Deferred Stock may be awarded either alone or in addition to other awards granted under the Plan. The Committee shall determine the officers and key employees of the Company and Subsidiaries to whom and the time or times at which Deferred Stock shall be awarded, the number of Shares of Deferred Stock to be awarded to any participant or group of participants, the duration of the period (the “Deferral Period”) during which, and the conditions under which, receipt of the Stock will be deferred, and the terms and conditions of the award in addition to those contained in paragraph (b) of this Section. The Committee may also condition the issuance of shares pursuant to a Deferred Stock 11 upon the attainment of specified performance goals. The provisions of Deferred Stock awards need not be the same with respect to each recipient.
- (b) Terms and Conditions. The following shall apply to each Deferred Stock award:
- (i) Subject to the provisions of this Plan and the award agreement, Deferred Stock awards may not be sold, assigned, transferred, pledged or otherwise encumbered during the Deferral Period. In no event shall the Deferral Period be less than eleven (11) months. At the expiration of the Deferral Period (or Elective Deferral Period, where applicable), share certificates shall be delivered to the participant, or his legal representative, for the number of shares that is equal to the number of shares to which the participant is entitled under the terms and conditions of the Deferred Stock award (the “Earned Shares”).
 - (ii) Amounts equal to any dividends declared during the Deferral Period with respect to Earned Shares may be paid to the participant during or at the conclusion of the Deferral Period, and such amounts may be deemed to be reinvested in additional Deferred Stock or otherwise reinvested, all as determined at the time of the award by the Committee, in its sole discretion.
 - (iii) Subject to the provisions of the award agreement and paragraph (b)(iv) of this Section, upon termination of employment for any reason during the Deferral Period for a given award, the Deferred Stock in question shall be forfeited by the participant.
 - (iv) In the event of special hardship circumstances of a participant whose employment is terminated (other than for Cause) including death, Disability or Retirement, or in the event of an unforeseeable emergency of a participant still in service, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interest of the Company, waive or amend in whole or in part any or all of the remaining deferral limitations imposed hereunder or in the Deferred Stock award with respect to any or all of the participant’s Deferred Stock during the Deferral Period.

If any Deferred Stock is subject to Section 409A of the Code, the Committee shall not waive or amend any deferral limitations with respect to such Deferred Stock during the Deferral Period and Elective Deferral Period, if any, unless such waiver or amendment is permitted under Section 409A of the Code and regulations promulgated thereunder.

- (v) A participant may elect to further defer receipt of the Earned Shares for a specified period or until a specified event (the "Elective Deferral Period"), subject in each case to the Committee's approval and to such terms as are determined by the Committee, all in its sole discretion. The Committee shall not approve any election to defer receipt of the Earned Shares or accelerate the Elective Deferral Period unless such election or acceleration is permitted under Section 409A of the Code and regulations thereunder.
- (vi) Each award shall be confirmed by, and subject to the terms of, a Deferred Stock agreement executed by the Company and the participant.

SECTION 9. Transfer, Leave of Absence, Etc.

For purposes of the Plan, the following events shall not be deemed a termination of employment:

- (a) a transfer of an employee from the Company to a Parent Corporation or Subsidiary, or from a Parent Corporation or Subsidiary to the Company, or from one Subsidiary to another;
- (b) a leave of absence, approved in writing by the Committee, for military service or sickness, or for any other purpose approved by the Company if the period of such leave does not exceed ninety (90) days (or such longer period as the Committee may approve, in its sole discretion); and
- (c) a leave of absence in excess of ninety (90) days, approved in writing by the Committee, but only if the employee's right to reemployment is guaranteed either by a statute or by contract, and provided that, in the case of any leave of absence, the employee returns to work within 30 days after the end of such leave.

SECTION 10. Amendments and Termination.

The Board may amend, alter, or discontinue the Plan, but no amendment, alteration, or discontinuation shall be made (i) which would impair the rights of an optionee or participant under a Stock Option, Stock Appreciation Right, Restricted Stock, Deferred Stock or other Stock-based award theretofore granted, without the optionee's or participant's consent, or (ii) which, without the approval of the stockholders of the Company, would cause the Plan to no longer comply with Rule 16b-3 under the Securities Exchange Act of 1934, Section 422 of the Code, or any other regulatory requirements.

The Committee may amend the terms of any award or option theretofore granted, prospectively or retroactively, but, subject to Section 3 above, no such amendment shall impair the rights of any holder without his consent. The Committee may also substitute new Stock Options for previously granted stock options, including previously granted stock options having higher exercise prices.

Amendment of the first paragraph of Section 3 of this Plan to increase the total number of shares of Stock reserved and available for distribution under the Plan shall be deemed to be the adoption of a new Plan with respect to the total number of shares reserved and available for distribution under the Plan after the date such amendment is approved by a vote of the holders of a majority of the stock present and entitled to vote at a meeting of the Company's shareholders.⁴

SECTION 11. Unfunded Status of Plan.

The Plan is intended to constitute an "unfunded" plan for incentive and deferred compensation. With respect to any payments not yet made to a participant or optionee by the Company, nothing contained herein shall give any such participant or optionee any rights that are greater than those of a general creditor of the Company. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver Stock or payments in lieu of or with respect to awards hereunder, provided, however, that the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

SECTION 12. General Provisions.

- (a) The Committee may require each person purchasing shares pursuant to a Stock Option under the Plan to represent to and agree with the Company in writing that the optionee is acquiring the shares without a view to distribution thereof. The certificates for such shares may include any legend which the Committee deems appropriate to reflect any restrictions on transfer.

All certificates for shares of Stock delivered under the Plan pursuant to any Restricted Stock, Deferred Stock or other Stock-based award shall be subject to such stock-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Stock is then listed, and any applicable federal or state securities laws, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

- (b) Subject to paragraph (d) below, recipients of Restricted Stock, Deferred Stock and other Stock-based awards under the Plan (other than Stock Options) are not required to make any payment or provide consideration other than the rendering of services.

⁴ This paragraph was added effective January 1, 2002 to incorporate the provisions of applicable tax law.

- (c) Nothing contained in this Plan shall prevent the Board of Directors from adopting other or additional compensation arrangements, subject to stockholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases. The adoption of the Plan shall not confer upon any employee of the Company or any Subsidiary any right to continued employment with the Company or a Subsidiary, as the case may be, nor shall it interfere in any way with the right of the Company or a Subsidiary to terminate the employment of any of its employees at any time.
- (d) Each participant shall, no later than the date as of which any part of the value of an award first becomes includable as compensation in the gross income of the participant for federal income tax purposes, pay to the Company, or make arrangements satisfactory to the Committee regarding payment of, any federal, state, or local taxes of any kind required by law to be withheld with respect to the award. The obligations of the Company under the Plan shall be conditional on such payment or arrangements and the Company and Subsidiaries shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the participant. With respect to any award under the Plan, if the terms of such award so permit, a participant may elect by written notice to the Company to satisfy part or all of the withholding tax requirements associated with the award by (i) authorizing the Company to retain from the number of shares of Stock that would otherwise be deliverable to the participant, or (ii) delivering to the Company from shares of Stock already owned by the participant, that number of shares having an aggregate Fair Market Value equal to part or all of the tax payable by the participant under this Section. Any such election shall be in accordance with, and subject to, applicable tax and securities laws, regulations and rulings.
- (e) At the time of grant, the Committee may provide in connection with any grant made under this Plan that the shares of Stock received as a result of such grant shall be subject to a repurchase right in favor of the Company, pursuant to which the participant shall be required to offer to the Company upon termination of employment for any reason any shares that the participant acquired under the Plan, with the price being the then Fair Market Value of the Stock or, in the case of a termination for Cause, an amount equal to the cash consideration paid for the Stock, subject to such other terms and conditions as the Committee may specify at the time of grant. The Committee may, at the time of the grant of an award under the Plan, provide the Company with the right to repurchase, or require the forfeiture of, shares of Stock acquired pursuant to the Plan by any participant who, at any time within two years after termination of employment with the Company, directly or indirectly competes with, or is employed by a competitor of, the Company.

- (f) The reinvestment of dividends in additional Restricted Stock (or in Deferred Stock or other types of Plan awards) at the time of any dividend payment shall only be permissible if the Committee (or the Company's chief executive or chief financial officer) certifies in writing that under Section 3 sufficient shares are available for such reinvestment (taking into account then outstanding Stock Options and other Plan awards).

SECTION 13. Effective Date of Plan.

The Plan shall be effective on the date it is approved by a vote of the holders of a majority of the Stock present and entitled to vote at a meeting of the Company's shareholders.

COMMUNICATIONS SYSTEMS, INC.

1990 STOCK OPTION PLAN FOR NONEMPLOYEE DIRECTORS

**ARTICLE I
PURPOSE**

The purposes of the 1990 Communications Systems, Inc. Stock Option Plan for Nonemployee Directors (the "Plan") are to attract and retain the services of experienced and knowledgeable nonemployee Directors of Communications Systems, Inc. (the "Corporation") and to provide an incentive for such Directors to increase their proprietary interest in the Corporation's long-term success and progress.

**ARTICLE II
SHARES SUBJECT TO THE PLAN**

The total number of shares of Common Stock, par value \$.05 (the "Shares"), of the Corporation for which options may be granted under the Plan is 300,000¹, subject to adjustment in accordance with Article VI hereof. Such Shares shall be authorized and unissued shares and shall include shares representing the unexercised portion of any option granted under the Plan which expires or terminates without being exercised in full.

**ARTICLE III
ADMINISTRATION OF THE PLAN**

The Plan shall be administered by the Board of Directors of the Corporation (the "Board"), or, in the event the Board shall appoint and/or authorize a Compensation Committee to administer this Plan, by such committee. Subject to the terms of the Plan, the Board shall have the power to construe the provisions of the Plan, to determine all questions arising thereunder and to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable.

**ARTICLE IV
PARTICIPATION IN THE PLAN**

Each Director of the Corporation who is not otherwise an employee of the Corporation or any subsidiary ("Director") shall receive annually an option to acquire 3,000 Shares² under the Plan subject to adjustment in accordance with Article VI hereof, concurrent with the annual meeting of the stockholders of the corporation (whether or not such Director is up for election), commencing with the 1990 election; provided that no options will be awarded after the 2010 annual meeting of stockholders.³

**ARTICLE V
OPTION TERMS**

Each option granted to a Director under the Plan and the issuance of Shares thereunder shall be subject to the following terms.

¹ Originally 100,000. Adjusted for stock split in 1993 to 200,000. In March 2001 the Board approved and in May 2001 the shareholders approved an increase to 300,000 shares.

² Originally 1,000 shares; increased from time to time, most recently at the May 18, 1999 Annual Shareholders meeting when the annual grant was increased to 3,000 shares.

³ Last clause approved by the Company's Board of Directors on August 11, 2011.

1. Option Agreement. Each option granted under the Plan shall be evidenced by an option agreement (the "Agreement") duly executed on behalf of the Corporation and by the Director to whom such options is granted. Each Agreement shall comply with and be subject to the terms and conditions of the Plan and shall conclusively evidence by the optionee's signature thereon that it is the intent of the optionee to serve as a director of the Corporation for the remainder of the calendar year in which the option was granted. Any Agreement may contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Board. No option shall be granted within the meaning of the Plan and no purported grant of any option shall be effective until such an option agreement shall have been duly executed on behalf of the Corporation and the Director to whom the option is to be granted.

2. Option Exercise Price. The option exercise price for an option granted under the Plan shall be the fair market value of the Shares covered by the option at the time the option is granted. For purposes of the Plan, "fair market value" may mean the closing price or the mean between the high and low sale prices quoted on the day of grant on the National Association of Securities Dealers Automatic Quotation System, whichever is less.

3. Time and Manner of Exercise of Option. Options are exercisable immediately after their grant and may be exercised in full at one time or in part from time to time. Any option may be exercised by giving written notice, signed by the person exercising the option, to the corporation stating the number of Shares with respect to which the option is being exercised, accompanied by payment in full for such Shares, which payment may be in whole or in part in Shares of the Common Stock of the Corporation already owned by the person or persons exercising the option, valued at fair market value at the time of such exercise.

4. Term of Options. Each option shall expire ten (10) years from the date of the granting thereof, but shall be subject to earlier termination as provided in the following sentence. In the event of the death of an optionee during the period in which he or she is a Director of the Corporation, or within the period between when the optionee ceases to be a director and the date on which the option would otherwise expire by its terms, the option granted to such optionee may be exercised only within one (1) year after the date of death of such optionee or prior to the date on which the option expires by its terms, whichever is earlier, by the estate of such optionee, or by any person or persons whom the optionee shall have designated in writing on forms prescribed by and filed with the Corporation or, if no such designation has been made by the person or persons to whom the optionee's rights have passed, by will or the laws of descent and distribution.⁴

5. Transferability. The right of any optionee to exercise an option granted to him or her under the Plan shall not be assignable or transferable by such optionee otherwise than by will or the laws of descent and distribution, and any such option shall be exercisable during the lifetime of such optionee only by such optionee; provided, however, notwithstanding the foregoing, that optionee may transfer the option to a revocable trust established by and, during the lifetime of the optionee, solely controlled by the optionee, and such trust shall possess the same rights with respect to the transferred option as were granted to the optionee, as well as the rights specified in paragraphs 3 and 4 of this Article IV.⁵

6. Participant's or Successor's Rights as Stockholder. Neither the recipient of an option under the Plan nor his or her successor(s) in interest shall have any rights as a stockholder of the Corporation with respect to any Shares subject to an option granted to such person until such person becomes a holder of record of such Shares.

⁴ Amended by written action of the Board effective March 30, 2007.

⁵ Amended at Board meeting held May 13, 2010

7. Regulatory Approval and Compliance. The Corporation shall not be required to issue any certificate or certificates for Shares of its stock upon the exercise of an option granted under the Plan or record as a holder of record of such Shares the name of the individual exercising an option under the Plan, without obtaining to the complete satisfaction of the Board the approval of all regulatory bodies deemed necessary by the Board, and without complying, to the Board's complete satisfaction, with all rules and regulations, under federal, state or local law deemed applicable by the Board.

**ARTICLE VI
CAPITAL ADJUSTMENTS**

The aggregate number of Shares with respect to which options may be granted under the Plan, as provided in Article II, the number of Shares for which options are to be granted annually under Article IV, the number of Shares subject to each outstanding option and the price per share specified in such options, all may be adjusted, as the Board shall determine at its sole discretion or as may be required, for any increase or decrease in the number of issued shares of Common Stock of the Corporation resulting from a subdivision or consolidation of Shares or any other similar capital adjustment, the payment of a stock dividend, or other increase or decrease in such Shares effected without receipt of consideration by, or a merger, or consolidation of, the Corporation, or the distribution of shares of another corporation as a stock dividend, or the sale of all or substantially all of the assets of, or the liquidation of, the Corporation.

**ARTICLE VII
EXPENSES OF THE PLAN**

All costs and expenses of the adoption and administration of the Plan shall be borne by the Corporation, and none of such expenses shall be charged to any optionee.

**ARTICLE VIII
APPROVAL OF STOCKHOLDERS**

The Plan shall be subject to approval by the vote of stockholders holding at least a majority of the voting stock of the Corporation, voting in person or by proxy at a duly held stockholders' meeting.

**ARTICLE IX
TERMINATION AND AMENDMENT OF THE PLAN**

The Board may amend, terminate or suspend the Plan at any time, in its sole and absolute discretion; provided, however, that without the approval of stockholders no amendment shall (1) increase the number of Shares subject to the Plan; (2) reduce the option price below 100% of the market value of the Shares, subject to adjustment under Article VI, the number of Shares for which options may be granted to each Director in a calendar year; or (4) change the timing with respect to which such options are granted.

**ARTICLE X
EFFECTIVE DATE**

The effective date of the Plan shall be the date on which the Plan is approved by its stockholders.

CERTIFICATION

I, William G. Schultz certify that:

1. I have reviewed this quarterly report on Form 10-Q of Communications Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal controls over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2011

By /s/ William G. Schultz
William G. Schultz
President and Chief Executive Officer

CERTIFICATION

I, David T. McGraw, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Communications Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal controls over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By /s/ David T. McGraw
David T. McGraw
Chief Financial Officer

Date: November 10, 2011

CERTIFICATION

The undersigned certify pursuant to 18 U.S.C. § 1350, that:

- (1) The accompanying Quarterly Report on Form 10-Q for the periods ended September 30, 2011, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the accompanying Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2011

By /s/ William G. Schultz
William G. Schultz
President and Chief Executive Officer

Date: November 10, 2011

By /s/ David T. McGraw
David T. McGraw
Chief Financial Officer

For Immediate Release:

**Contact: William G. Schultz, President and Chief Executive Officer
David T. McGraw, Vice President – Finance and Chief Financial Officer
Telephone 952-996-1674**

**Communications Systems, Inc. Reports
Third Quarter 2011 Results**

Minnetonka, MN ---- November 9, 2011----- Communications Systems, Inc. (NASDAQ: JCS) today reported financial results for its third quarter and nine months ended September 30, 2011.

For the three months ended September 30, 2011, net income was \$3,730,000, or \$0.44 per diluted share, on sales of \$41,985,000. For the same period in 2010, the Company earned \$3,999,000, or \$0.48 per diluted share, on sales of \$33,324,000. For the nine months ended September 30, 2011, net income was \$10,372,000, or \$1.22 per diluted share, on sales of \$118,437,000. The results for the nine months ended September 30, 2011 include a charge of \$1,300,000 for reduction in goodwill taken in the second quarter of 2011. For the same nine-month period in 2010, the Company earned \$7,746,000, or \$0.92 per diluted share, on sales of \$89,865,000.

William G. Schultz, President and CEO, commented: “Our quarterly and year-to-date results were bolstered by a large network upgrade project at a Fortune 500 company that our Transition Networks’ business unit was awarded earlier this year. This upgrade began in the second quarter and was substantially completed at the end of the third quarter. This one-time project contributed \$13 million in revenue for the quarter and \$33 million for the nine months ended September 30, 2011. While we are pleased with our overall quarterly and year-to-date results, apart from increased sales to this customer, we saw a decrease in some of the traditional business in our Transition Networks business unit compared to the third quarter of last year. These declines were attributable, in part, to the slowdown in U.S. government purchasing. Schultz continued, “On July 27, 2011, the Company acquired Patapsco Designs Limited of the UK (“Patapsco”) for its Transition Networks business unit. The purchase price totaled \$5,031,000, with cash acquired totaling \$862,000. Despite the continuing weakness in the economy and the challenges in some of our traditional markets, our acquisition of Patapsco reflects our commitment to expand our product lines through acquisitions that complement our existing business units as well as investment into developing new products organically. In addition to our continued search for acquisitions and our investment in product development, we are adding resources to sales and marketing to grow both domestically and globally. We feel our business units are well positioned in good markets with solid long term growth potential.”

Further information regarding the Company’s results and related matters is provided in the Company’s Form 10-Q report for the quarter ended September 30, 2011 that is being filed on or about November 10, 2011.

Cautionary Statement

From time to time, in reports filed with the Securities and Exchange Commission, in press releases, and in other communications to shareholders or the investing public, Communications Systems Inc. may make forward-looking statements concerning possible or anticipated future financial performance, business activities or plans which are typically preceded by the words “believes,” “expects,” “anticipates,” “intends” or similar expressions. For these forward-looking statements, the Company claims the protection of the safe harbor for forward-looking statements contained in federal securities laws. Shareholders and the investing public should understand that these forward-looking statements are subject to risks and uncertainties, including those disclosed in our periodic filings with the SEC, which could cause actual performance, activities or plans after the date the statements are made to differ significantly from those indicated in the forward-looking statements when made.

About Communications Systems

Communications Systems, Inc. provides physical connectivity infrastructure and services for global deployments of broadband networks. Focusing on innovative, cost-effective solutions, CSI provides customers the ability to deliver, manage, and optimize their broadband network services and architecture. From the integration of fiber optics in any application and environment to efficient home voice and data deployments to the optimization of data and application access, CSI provides the tools for maximum utilization of the network from the edge to the user. With partners and customers in over 50 countries, CSI has built a reputation as a reliable global innovator focusing on quality and customer service.

CSI CONSOLIDATED SUMMARY OF EARNINGS
Selected Income Statement Data

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Sales	\$ 41,984,570	\$ 33,323,793	118,437,057	\$ 89,864,628
Gross margin	16,555,270	15,309,984	48,339,344	39,109,053
Operating income	6,483,862	6,304,285	17,877,980	12,616,473
Income before income taxes	6,574,906	6,354,557	18,000,051	12,635,099
Income taxes	2,845,269	2,355,163	7,627,910	4,889,452
Net income	\$ 3,729,637	\$ 3,999,394	10,372,141	\$ 7,745,647
Basic net income per share	\$ 0.44	\$ 0.48	1.23	\$ 0.92
Diluted net income per share	\$ 0.44	\$ 0.48	1.22	\$ 0.92
Cash dividends per share	\$ 0.15	\$ 0.15	0.45	\$ 0.44
Average basic shares outstanding	8,458,151	8,398,496	8,441,978	8,376,542
Average dilutive shares outstanding	8,530,187	8,414,865	8,500,022	8,401,212

Selected Balance Sheet Data

	September 30, 2011	December 31, 2010
Total assets	\$ 116,713,605	\$ 109,070,227
Cash, cash equivalents and investments	43,322,898	43,074,730
Property, plant and equipment, net	13,424,106	13,214,067
Long-term liabilities	3,738,957	5,004,156
Stockholders' equity	98,775,657	91,396,693
